

DEATH AND TAXES — II

INCOME TAXATION DEVICES APPLIED TO THE DECEDENT, HIS ESTATE AND HIS SUCCESSORS

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Distinctions which originated in a feudal economy when land dominated social relations are peculiarly irrelevant in the applications of tax measures now so largely directed toward intangible wealth.

MR. JUSTICE FRANKFURTER**

INTRODUCTION

Devolution of property to a decedent's successors follows three principal patterns: the simplest is based upon centuries of ecclesiastical probate administration; a second major category is rooted in ancient feudal real estate patterns; and a third basic variety originated in newer, direct designation arrangements largely based on contract.¹ These existent methods are the end products of three diverse histories undergirding the major property doctrines in the systems of state law.² On their differing results has been superimposed an effective federal method of taxing successors on the passage of property values.³

Even though the taxing system works reasonably well in assessing estate tax cost against all three types of transmission of economic value, the locus of the burden of the payment of the tax cost seems inequitable in some applications because of persisting rules traceable to the historical origins out of which the system arose.⁴ This inequity is the fault of the federal taxing system only by indirection; it has ac-

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** *Helvering v. Hallock*, 309 U.S. 106, 451, 23 Am. Fed. Tax Rev. 1054, 1061, 40-1 U.S.T.C. ¶ 9208 (1940). "[E]lusive and subtle casuistries . . . may have their historic justification but possess no relevance for tax purposes . . . [They] derive from medieval concepts . . ." The Supreme Court refuses "to subordinate the plain purposes of a modern fiscal measure to the wholly unrelated origins of the recondite learning of ancient property law."

¹ This treatment is essentially an extension and correlated continuation into the income tax field of "Death & Taxes I," 22 Ohio St. L.J. 327 (1961). Many references here have been developed in that portion which ought to be imported here.

² "Death & Taxes I," *supra* page 328 notes 5 through 7.

³ That the Federal estate taxing system is largely effective as to the scope of its definitional includibility we noticed in *Death & Taxes I*, in the text *supra* at note 55.

⁴ See "Death and Taxes I," Table 1 *supra* page 330.

cepted uncritically a partially defective method for the imposition of the burdens of estate taxes against successions determined according to local law.⁵

The federal income tax method seeks to trace net taxable income to somebody, irrespective of the fact of the taxpayer's demise. The fact of death ought neither to reduce nor increase the income tax cost. The decedent's passing ought not to cause loss of deductions unclaimed for income tax purposes. Practical tax effect ought to be accorded to the related deductions which result from death. These objectives are accomplished through technical concept known as income in respect of a decedent, and its counterpart in deductibility. It is supplemented by the newer distributive net income technique and termination deductions. All of these are used to pass these results to various taxpayer persons.

INCOME TAX RETURNS OF THE DECEDENT AND HIS SURVIVING SPOUSE

The last income tax return of the decedent ends at the date of his death⁶ and must include all of the taxable income taxable to that time⁷ and the deductibles paid until then. The decedent's return may be filed jointly with the surviving spouse at her option⁸ if she has not remarried,⁹ but the executor may disaffirm.¹⁰ The spouse can refuse to join in the joint return in the presence of potential income tax liabilities of the decedent with inadequate probate assets out of which to pay the joint debt¹¹ created by the election to file jointly.¹² A fiduciary was ordered to join with the surviving spouse in executing a joint return in order to save income taxes through the income-split.¹³

⁵ See "Death & Taxes I" *supra*, cases cited at notes 5-8; notes 89-95; note 97.

⁶ Treas. Reg. § 1.451-1(b)(1) (1957).

⁷ The cash method of accounting also includes all items constructively received under Treas. Reg. § 1.451-2 (1957), even though not actually paid after death.

⁸ Int. Rev. Code of 1954, § 6013(a)(3) permits a joint return by the surviving spouse if no fiduciary has been appointed by the due date of the return.

⁹ Treas. Reg. § 1.6013-1(d)(3) (1959).

¹⁰ The executor may disaffirm within 1 year from the due date. Int. Rev. Code of 1954, § 6013(a)(3); Treas. Reg. § 1.6013-1(d)(2) (1959).

¹¹ Joint liability is a matter of intention and ought to be rejected if a debt will be credited with no probate assets out of which to pay. Consider the narrow escape of Eva M. Manton, 11 T.C. 831 (1948), *acq.*, 1949-1 Cum. Bull. 3 as the result of the machinations of Circuit Judge Martin Manton reflected in *Manton v. United States*, 107 F.2d 834 (2d Cir.), *cert. denied*, 309 U.S. 664 (1938).

¹² The unpaid income tax liability of the decedent is a claim against the probate estate. See "Death and Taxes I," *supra* notes 80-81. It may not be against the non-probate assets. *Comm'r v. Stern*, 357 U.S. 39, 1 Am. Fed. Tax R.2d 1899, 58-2 U.S.T.C. ¶ 9594 (1958); *United States v. Bess*, 357 U.S. 51, 1 Am. Fed. Tax R.2d 1904, 58-2 U.S.T.C. ¶ 9595 (1958).

¹³ *Estate of Frank J. Floyd*, 72 Pa. D. & C. 406, 43 Am. Fed. Tax R. 1301, 51-2 U.S.T.C. ¶ 9415 (Orphans' Ct. 1951).

When the joint return is filed, the decedent's proportionate share of the income tax liability¹⁴ is a debt of the decedent;¹⁵ but conversely, the amount withheld from salaries for payment to the government by his employer, and payments on decedent's estimated income tax are assets of the decedent's estate and includible for estate tax purposes accordingly.¹⁶

The last income tax return can include an optional special election to accrue previously untaxed United States Treasury discount bond interest even though the method had never before been elected by the decedent.¹⁷ This special option can be exercised for the decedent in his last income tax return, or it can be elected by the estate or by any successor, but the election must apply to all bonds owned.¹⁸ Alternatively, the effect of partial election by the estate or by successors can be accomplished by an actual redemption of the desired amount; this will produce cash realization of the income for taxation.¹⁹

Medical expenses of the decedent paid within one year after death can be deducted in his last return²⁰ or deducted in the estate tax return²¹ or deducted by the surviving spouse in the year of payment.²²

The income tax returns of the surviving spouse for the two years following death can use the income splitting rate method if she has not remarried and if she maintains a household for a dependent.²³

TRACING DECEDENT'S UNTAXED INCOME TO HIS SUCCESSORS

A taxable income or deduction event must occur either in the form of a cash receipt or payment, or as a taxable accrual of right or offsetting liability. The requirement carries with it the possibility that an item may have escaped the claims of the tax collector or the right of the taxpayer before death. Add to this corpus-income concepts from property law and their derivative argument—a right accrued at death is a fixed property right—the income tax can only fall on

¹⁴ Proportionate allocation is required based on relative amounts of husband's income and wife's income. Rev. Rul. 57-78, 1957-1 Cum. Bull. 300.

¹⁵ Compare *Mills v. United States*, 4 Am. Fed. Tax R.2d 6102, 59-2 U.S.T.C. ¶ 11,894 (S.D. Ga. 1959).

¹⁶ Int. Rev. Code of 1954, § 2033.

¹⁷ Int. Rev. Code of 1954, § 454(a); Treas. Reg. § 1.454-1(a) (1957).

¹⁸ Int. Rev. Code of 1954, § 454(a).

¹⁹ The same rule applies to any taxpayer; but successors are not required to accrue because the earlier owner did so. Treas. Reg. § 1.454-1(a) (1957).

²⁰ Int. Rev. Code of 1954, § 213(d); Treas. Reg. § 1.213-1(d) (1960), but double deductions are not permissible. Int. Rev. Code of 1954, § 642(g).

²¹ Int. Rev. Code of 1954, § 2053(a) (3).

²² Int. Rev. Code of 1954, § 213(a); Treas. Reg. § 1.213-1(a) (3) (i) (1960).

²³ Int. Rev. Code of 1954, § 2(b).

"incomes from whatever source derived."²⁴ Since the property right transmitted at death is no longer income in the property sense, perhaps it could not be taxed. Of course, the argument could not stand scrutiny: its fallacy lay in equating constitutional taxing power over income with the probate and trust law category of income as a conceptual method used in distributing property benefits.²⁵

Until 1934, no income tax was assessed against a decedent nor against his successors.²⁶ The rule was the opposite from 1934 until 1942: an income tax was assessed particularly because of death.²⁷ This was unfair to the successors because of the extra income tax cost it produced through the bunching effect in the last income tax return.²⁸ Since 1942, the new concept of income in respect of a decedent has been the common standard,²⁹ and by explicit statutory command, no accruals of income result from death alone.³⁰

As originally enacted, the concept of income in respect of a decedent was not defined. The administrative interpretation now applicable supplies some assistance in determining its meaning:

Income in respect of a decedent refers to those amounts to which a decedent was entitled as gross income but which were not properly includible in computing his taxable income for the taxable year ending with the date of his death or for a previous taxable year under the method of accounting employed by the decedent . . . (including):

- (1) All accrued income of a decedent who reported his income by use of the cash receipts and disbursements method;
- (2) Income accrued solely by reason of the decedent's death in case of a decedent who reports his income by use of an accrual method of accounting; and
- (3) Income to which the decedent had a contingent claim at the time of his death.³¹

²⁴ U.S. Const. amend. XVI.

²⁵ Gifts and inheritances are ordinarily exempt from income taxation, but not if the inheritance is an income right. Int. Rev. Code of 1954, § 102(b). Income rights actually become corpus at death under probate and trust law. Consider the effects of this doctrine on the federal law of income taxation which was argued in *Richardson v. United States*, 177 F. Supp. 394, 4 Am. Fed. Tax R.2d 5642, 59-2 U.S.T.C. ¶ 9712 (E.D. Mich. 1959) (app. to 6th Cir. 1960).

²⁶ *Nichols v. United States*, 64 Ct. Cl. 241, 6 Am. Fed. Tax R. 7101 (1927).

²⁷ *Helvering v. Enright's Estate*, 312 U.S. 636, 25 Am. Fed. Tax R. 1213, 41-1 U.S.T.C. ¶ 9356 (1941); *Putman's Estate v. Comm'r*, 324 U.S. 393, 33 Am. Fed. Tax R. 599, 45-1 U.S.T.C. ¶ 9234 (1945).

²⁸ This bunching effect was particularly noticed in *Comm'r v. Linde*, 213 F.2d 1, 45 Am. Fed. Tax R. 1522, 54-1 U.S.T.C. ¶ 9384 (9th Cir.), *cert. denied*, 348 U.S. 871 (1954), noted in 33 Taxes 675 (1955), and in *Lacomble v. United States*, 177 F. Supp. 373, 4 Am. Fed. Tax R.2d 5563, 59-2 U.S.T.C. ¶ 9692 (N.D. Calif. 1959).

²⁹ Int. Rev. Code of 1954, § 691.

³⁰ Int. Rev. Code of 1954, § 451(b).

³¹ Treas. Reg. § 1.691(a)-1(b) (1957).

The courts have applied a broad test of includibility for the most part: pregnant property which carries untaxed income rights derived from the decedent is almost certainly taxable to the successors to whom it devolves.³² Conversely, if the item in question could have never been income to the decedent, it can not be income to his successors.³³ The same generic concepts of income persist after death as before; mere accretion of value unaccompanied by a taxable event is not recognized as a taxable income factor. Thus a cash basis farmer who has untaxed inventories of agricultural products on hand at death is not subject to income tax at death on their value.³⁴ But if there is another event present, such as where he has set in motion the marketing processes so that their crop status has been replaced by unsatisfied obligations of payment by others, the untaxed profit is income in respect of decedent.³⁵ Increase in the value of corporate shares arising from an enforceable buy-sell agreement entered into during life will not be taxed as income to the successors when the redemption is accomplished.³⁶ Of course, if the stepped-up-basis-at-death provisions of section 1014 of the Internal Revenue Code apply, there is no possibility of income in respect of decedent; the two concepts are statutorily defined to be mutually exclusive.³⁷

The broad sweep of many decisions has seemed to find taxability to successors arising out of a decedent's untaxed income in three major areas:

- (1) Almost all items of untaxed value based on a decedent's personal services during his lifetime are later taxed to somebody.³⁸ An earlier difficulty in the method of taxing partners post-mortem income has been clarified.³⁹ About

³² Estate of O'Daniel v. Comm'r, 173 F.2d 966, 37 Am. Fed. Tax R. 1249, 49-1 U.S.T.C. ¶ 9235 (2d Cir. 1949); and see Estate of Riegelman v. Comm'r, 253 F.2d 315, 1 Am. Fed. Tax R.2d 2117, 58-1 U.S.T.C. ¶ 11,753 (2d Cir. 1958) (right to post death income from law partnership subject to income tax under Internal Revenue Code of 1954, § 691 is therefore an includible asset for estate tax purposes under Internal Revenue Code of 1954, § 2031).

³³ Treas. Reg. § 1.691(a)-1(d) (1957); Rev. Rul. 59-64, 1959-1 Cum. Bull. 31 (items excluded from includible income under Internal Revenue Code of 1954, § 105 retain this character in hands of successors).

³⁴ Estate of Tom L. Burnett, 2 T.C. 897 (1943). This case applies equally under current law. Rev. Rul. 58-436, 1958-2 Cum. Bull. 366.

³⁵ Comm'r v. Linde, *supra* note 28; Treas. Reg. § 1.691(a)-2, examples (5) and (2) (1957).

³⁶ Treas. Reg. § 1.691(a)-2(b), example (4) (1957).

³⁷ Int. Rev. Code of 1954, § 1014(c); compare Rev. Rul. 58-436, 1958-2 Cum. Bull. 366.

³⁸ See table 3-1 at 355, items 1(a) through 1(m).

³⁹ Partnership income as such is no different in nature than income realized by any

TABLE 3-1
 "INCOME IN RESPECT OF DECEDENT"
 JUDICIAL & ADMINISTRATIVE APPLICATIONS

| DESCRIPTION OF VALUES TRANSMITTED AT DEATH | AUTHORITIES AND COMMENTS |
|---|--|
| 1—ITEMS PRINCIPALLY BASED ON SERVICES PERFORMED DURING DECEDENT'S LIFETIME | |
| (a) Post-mortem salary payments by employer to the estate are decedent's § 691 income | Estate of Bausch v. Comm'r, 186 F.2d 313, 40 Am. Fed. Tax R. 61 (2d Cir. 1951) (under Int. Rev. Code of 1939) Treas. Reg. § 1.691(a)-2(b), example (1) (1957) |
| (b) Non taxable payments in lieu of salary are not taxable under § 691 (a) if they would not have been taxable to the decedent by life-time payment | Rev. Rul. 59-64, 1959-1 Cum. Bull. 31 |
| (c) Gratuitous post-mortem payments up to \$5000 to a widow or successor are not income in respect of decedents under § 691(a) | Int. Rev. Code of 1954, § 101(b) Treas. Reg. § 1.691(a)-1(d) (1957) |
| (d) Gratuitous post-mortem payments to a widow in excess of \$5000 may or may not be § 691 income | See note 40 for the reflection of a long struggle still continuing on this issue |
| (e) Insurance renewals commission paid after death are decedent's § 691 income | Latendresse v. Comm'r, 243 F.2d 577, 51 Am. Fed. Tax R. 145 (7th Cir.), <i>cert. denied</i> , 355 U.S. 830 (1957); Treas. Reg. § 1.691(a)-2(b) example (2) (1957) |
| (f) Post-mortem payments for unused leave time due to a government employee are decedent's § 691 income | Rev. Rul. 55-229, 1955-1 Cum. Bull. 75. See also I.T. 3801, 1946-1 Cum. Bull. 109 |
| (g) Accounts receivable paid off after death for services rendered are usually decedent's § 691 income | Dixon v. United States, 96 F. Supp. 986, 40 Am. Fed. Tax R. 563 (E.D. Ky. 1950), <i>aff'd per curiam</i> , 192 F.2d 92 (6th Cir. 1951). |
| (h) Contingent fees for services will be decedent's § 691 income | O'Daniels Estate v. Comm'r, 173 F.2d 966, 37 Am. Fed. Tax R. 1249 (2d Cir. 1949); Friedman, "Estate and Income Tax Aspects of Fees Due at Death," 18 N.Y.U. Inst. Fed. Tax. 1293 (1960). |
| (j) Income resulting from an employee's restricted stock option which passed from a decedent is decedent's § 691 income | Int. Rev. Code of 1954, § 421(d)(6). |
| (k) Authors publication royalties paid post-mortem are decedent's § 691 income | Rev. Rul. 57-544, 1957-2 Cum. Bull. 361; Rev. Rul. 60-227, 1960-1 Cum. Bull. 262; Sutter, "(Revenue) Ruling 60-227 clarifies income in respect of a decedent arising from property," 14 Journal of Taxation 214 (April, 1961). |
| (m) Post-mortem payments to partners for their earnings are now explicitly covered by Internal Revenue Code § 691(e) | See note 39; Int. Rev. Code of 1954, § 753. |

TABLE 3-2
"INCOME IN RESPECT OF DECEDENT"
JUDICIAL & ADMINISTRATIVE APPLICATIONS

| DESCRIPTION OF VALUES TRANSMITTED AT DEATH | AUTHORITIES & COMMENTS |
|---|---|
| 2—ITEMS PRINCIPALLY BASED ON INCOME FROM TRADITIONAL PROPERTY RIGHTS | |
| (n) Dividends declared as of an ante-mortem record date payable after date of death are decedent's § 691 income when paid post-mortem | Putnams Estate v. Comm'r, 324 U.S. 393, 33 Am. Fed. Tax R. 599 (1945) (before § 691 was enacted); compare Lowndes & Kramer, "The Accrual of Corporate Dividends Under The Federal Estate Tax," 16 U. Pitt. L. Rev. 46 (1954). |
| (p) Ante-mortem interest owed to the decedent at death is decedent's § 691 income | Richardson v. United States, 177 F. Supp. 394, 4 Am. Fed. Tax R.2d 5642 (E.D. Mich. 1959) (app. to 6th Cir. 1960). |
| (q) United States government bond interest must be classified by type of issue: Untaxed ante-mortem interest from Series E bonds can be decedent's § 691 income [Consider the election to accrue E bond interest in the last return of the decedent: this will eliminate § 691(a) income] Untaxed post-mortem interest on G bonds not due until after death is not includible as § 691(a) income | Treas. Reg. § 1.691(a)-2(b), example (3) (1957). Rev. Rul. 58-435, 1958-2 Cum. Bull. 370. Int. Rev. Code of 1954, § 454(a). Estate of Willis L. King, 18 T.C. 414 (1952), <i>acq.</i> , 1953-1 Cum. Bull. 5. |
| (r) Defaulted interest which originated after purchase by decedent is decedent's § 691 income, not return of capital | Herbert Payson, 18 CCH Tax Ct. Mem. 686, 28 P-H Tax Ct. Mem. 596 (1959). |
| (s) Promissory notes representing uncollected rentals for periods before death for cash basis taxpayer collected after death by estate are decedent's § 691 income | Estate of Ostella Carruth, 28 T.C. 871 (1957). |
| (t) Distributable net income from trusts and estates accrued at date of death payable at later date is decedent's § 691 income | Treas. Reg. § 1.652(c)-2 (1956); Treas. Reg. § 1.662(c)-2 (1956). Compare also Rev. Rul. 59-346, 1959-2 Cum. Bull. 165. |
| (u) Income in respect of one or more prior decedents is income in respect to the instant decedent | Treas. Reg. § 1.691(a)-1(c) (1957). Rev. Rul. 57-544, 1957-2 Cum. Bull. 361. See also Treas. Reg. § 1.691(a)-4(b)(1) (1957). Edna S. Ullman, 34 T.C. No. 114 (1960). |
| (v) Accumulations in a building and loan deposit account untaxed to the decedent are income in respect of decedent | Estate of William P. Cooper, 19 CCH Tax Ct. Mem. 521, 29 P-H Tax Ct. Mem. 585 (1960) (app. 4th Cir. 1960). |
| (w) Alimony arrears payable to the wife's estate is decedent's § 691 income | Estate of Sarah L. Naraschkine, 14 T.C. 1128 (1950), <i>aff'd per curiam</i> , 189 F.2d 257 (2d Cir. 1951). |
| (x) Damage claims pending at death will carry § 691 income if they would have been taxable income items to the decedent | Rev. Rul. 55-463, 1955-2 Cum. Bull. 277. Adele Trounstone, 18 T.C. 1233 (1952), <i>rev'd on other grounds</i> , 213 F.2d 78, 46 Am. Fed. Tax R. 1782, 54-2 U.S.T.C. ¶ 9359 (3d Cir. 1954). |
| (y) Post-mortem earning power of an estate asset is not § 691 income; thus interest on installment payments due for deceased partner's interest is not decedent's § 691 income since it did not arise prior to death | Mandel v. Sturr, 266 F.2d 321, 3 Am. Fed. Tax R.2d 1323, 59-1 U.S.T.C. ¶ 9443 (2d Cir. 1959). |

TABLE 3-3
 "INCOME IN RESPECT OF DECEDENT"
 JUDICIAL & ADMINISTRATIVE APPLICATIONS

| DESCRIPTION OF VALUES TRANSMITTED AT DEATH | AUTHORITIES & COMMENTS |
|--|---|
| 3—INCOME PRINCIPALLY BASED ON CAPITAL VALUES OR TRANSACTIONS WHICH ORIGINATED DURING THE LIFETIME OF THE DECEDENT | |
| (aa) Decedent's untaxed rights to installment payments for lifetime transactions are decedent's § 691 income | Int. Rev. Code of 1954, § 691(a)(4); Treas. Reg. § 1.691(a)-5 (1957). |
| (bb) Decedent's right to receive payment for sales of his property: Completed during his lifetime but paid post-mortem are decedent's § 691 income Set in motion during his lifetime but not consummated are not decedent's § 691 income | Treas. Reg. § 1.691(a)-2, example (4). example (5)(1), (2) (1957). Treas. Reg. § 1.691(a)-2, example (5)(2) (1957). |
| (cc) Cash basis farmers date of death inventory is not income in respect of decedent, thereby escapes income taxation altogether | Estate of Tom L. Burnett, 2 T.C. 897 (1943). Under § 1014(b), basis is stepped up, therefore no income tax results at sale at date of death value. This rule is equally applicable under the Internal Revenue Code of 1954, § 691(a); Rev. Rul. 58-436, 1958-2 Cum. Bull. 366. |
| (dd) But when the decedent has set the liquidation process into motion and it is nearly complete, the profit is decedent's income under § 691(a) | Comm'r v. Linde, 213 F.2d 1, 45 Am. Fed. Tax. R. 1522, 54-1 U.S.T.C. ¶ 9384 (9th Cir.), <i>cert. denied</i> , 348 U.S. 871 (1954), noted in 33 Taxes 675 (1955). |
| (ee) Unmatured crops are not decedent's § 691 income to anybody | Treas. Reg. § 1.691(a)-2(b), example (5)(1) and example (5)(2) (1957). Perry v. United States, 160 F. Supp. 270, 1 Am. Fed. Tax R.2d 2028, 58-1 U.S.T.C. ¶ 9400 (Ct. Cl. 1958). |
| (ff) Untaxed profit based upon an inter vivos redemption or sale agreement exercisable only at death, but consummated post-mortem is not taxable income | Treas. Reg. § 1.691(a)-2(b), example (4) (1957). |
| (gg) Amounts received by a surviving annuitant under a joint and survivor annuity contract give rise to an estate tax deduction for income tax purposes | Int. Rev. Code of 1954, § 691(d). |

the only real exception is the on-going dispute over treatment of voluntary payments made by an employer to widows and successors.⁴⁰

other type of entity. But for partnerships particularly, taxing theories in use until 1954 caused serious problems of bunching as a result of death. Here is how the question might come up: the partners taxable year in which ended the ordinary partnership fiscal year would include a 12 month period. If death occurred any time up to eleven months later in the same taxable year for the partner, the partnership taxable year would again come to an end and the second group of months would therefore fall into the same return. This classical example is illustrated by the implications of *Comm'r v. Estate of Tyree*, 215 F.2d 78, 45 Am. Fed. Tax R. 1872, 54-2 U.S.T.C. ¶ 9505 (10th Cir. 1954); *Grant v. Busey*, 230 F.2d 290, 49 Am. Fed. Tax R. 227, 56-1 U.S.T.C. ¶ 9281 (6th Cir. 1956); consult also Weyler & Flom, "Death and Income Taxes—The Demise of a Partner," 52 Colum. L. Rev. 695 (1952).

New statutory provisions now prevent the death of a partner from closing his taxable year. Int. Rev. Code of 1954, § 706(c)(1); see also Int. Rev. Code of 1954, § 451(b). All post-mortem partnership income is now taxed as income in respect of decedent under Internal Revenue Code of 1954, § 691. Int. Rev. Code of 1954, §§ 753, 736(a); see Repetti, "Death of a Partner," 13 N.Y.U. Inst. Fed. Tax. 921 (1955).

The partners income to date of death will also be an includible asset for estate tax purposes. *Estate of Riegelman v. Comm'r*, *supra* note 32. The death benefit exemption available to an employee under Internal Revenue Code of 1954, § 101(b) does not apply to income paid to the widow of a partner. *Mary Tighe*, 33 T.C. 557, 567 (1959).

⁴⁰ The long dispute over the various tax implications attending the payment of voluntary consolatory disbursements to estates and widows of deceased employees shows only a clouded future. Substantial fact differences have characterized a long continuing struggle during which, until recently, the government often seemed sure to lose both ways.

The employer has usually managed to sustain deduction for post-mortem payments to employees. Consult among others, *Nixon v. United States*, 52 Am. Fed. Tax R. 1650, 57-2 U.S.T.C. ¶ 9982 (E.D. Tenn. 1957), *appeal dismissed*, (6th Cir. 1958); and *Fifth Avenue Coach Lines Inc.*, 31 T.C. 1080 (1959), *modified on other issues*, 281 F.2d 556, 6 Am. Fed. Tax R.2d 5665, 60-2 U.S.T.C. ¶ 9628 (2d Cir. 1960), appealed to Supreme Court January 7, 1961; *Rabkin & Johnson*, Federal Income Gift & Estate Taxation § 14.13(4) (1951).

On the employees side, compensation paid by reason of an employer's contractual obligation is taxable both as decedent's § 691 income and for estate tax purposes. *Estate of Riegelman v. Comm'r*, 253 F.2d 318, 1 Am. Fed. Tax R.2d 2119, 58-1 U.S.T.C. ¶ 11,753 (2d Cir. 1958); *Estate of O'Daniel v. Comm'r*, 173 F.2d 966, 37 Am. Fed. Tax R. 1249, 49-1 U.S.T.C. ¶ 9235 (2d Cir. 1949); *Treas. Reg. § 20.2039-1(b)* (1958); *Bilder*, "Death Benefits Paid Under an Express Contract," 34 Taxes 529 (1956); *Note*, 66 Yale L.J. 1217 (1957). Even in the absence of an explicit binding contract to do so, the long continued conduct of some employers in this direction creates taxability as being the practical equivalent of an express contract. *Simpson v. United States*, 261 F.2d 497, 2 Am. Fed. Tax R.2d 6036, 58-2 U.S.T.C. ¶ 9923 (7th Cir. 1958), *cert. denied*, 359 U.S. 944 (1959).

In the absence of an enforceable contract, it was hardly surprising that payments made by the employer to the decedent's estate would be held to be income in respect of decedent. *Bausch v. Comm'r*, 186 F.2d 313, 40 Am. Fed. Tax R. 61, 51-1 U.S.T.C. ¶ 9146 (2d Cir. 1951). This seems reasonable enough since the estate is the lineal legal successor of the deceased employee himself.

- (2) Quite similar, the income thrown off by conventional property holdings before the decedent's death but realized after death are taxed somewhere when they have been reduced

Perhaps because the nexus between the employment and the widow seemed considerably more tenuous when the estate was not present as the named beneficiary, gifts to widows have been repeatedly held non-taxable for income tax purposes. Fathered perhaps by some overly favorable early administrative rulings, a long series of disastrous cases under the Internal Revenue Code of 1939 produced a singularly unsuccessful litigation pattern. *Louise K. Aprill*, 13 T.C. 707 (1949), *acq.*, 1950-2 Cum. Bull. 1, *non acq.*, 1957-2 Cum. Bull. 8. In 1958, the government announced abandonment of litigation of cases which arose under the former code. Rev. Rul. 58-613, 1958-2 Cum. Bull. 914.

The Revenue Service has been contending that since 1954, a new provision in Internal Revenue Code, § 101(b)(2), changed the old rule. It has ruled that only \$5,000 paid by reason of the death of the employee is income tax exempt, and that all over that amount is taxable to the recipient as income. Rev. Rul. 60-326, 1960 Int. Rev. Bull. No. 42, at 11. This argument has met with both rejection and success. In the first direct ruling under the new code, the payments were held non-taxable. *United States v. Reed*, 277 F.2d 456, 5 Am. Fed. Tax R.2d 1141, 60-1 U.S.T.C. ¶ 9349 (6th Cir. 1960). *Accord*, *Cowan v. United States*, 6 Am. Fed. Tax R.2d 5499 (N.D. Ga. 1960). The government's position has been accepted by the Tax Court in *Estate of Mervin G. Pierpont*, 35 T.C. No. 10 (1960) which rejected the *Reed* doctrine. Compare also *United States v. Kasynski*, 284 F.2d 143, 6 Am. Fed. Tax R.2d 6060 (10th Cir. 1960) which appears to be in accord with *Reed* but explicitly relied on significant fact differentials highlighted in *Comm'r v. Duberstein*, 363 U.S. 278, 5 Am. Fed. Tax R.2d 1629 (1960); see also *Richards*, "Voluntary Payments to Widows or Beneficiaries of Deceased Employees," 22 Ohio St. L.J. 318 (1961).

It may be begging the question to rely on the Internal Revenue Code of 1954, § 102(b) which refuses gift treatment where the gift is income from property.

A revised approach by the government to measure deductibility by the employer seems reasonable enough to require caution in laying out future conduct. The crucial inquiry can be directed at the key search for the presence of an employer's obligation.

If there be a contract to pay a benefit at death, or conduct which approximates it, the disbursement is plainly deductible assuming that the total compensation was reasonable in amount. Int. Rev. Code of 1954, §§ 162(a), 212, 404(a); Treas. Reg. § 1.404(a)-1(b) (1956). Contrast with this the non-enforceable moral obligation rule: payment of an unenforceable obligation is not deductible because payment of moral obligations by businesses is not ordinary and not legally necessary. *Welch v. Helvering*, 290 U.S. 111, 12 Am. Fed. Tax R. 1456, 3 U.S.T.C. ¶ 1164 (1933). If payment of a moral obligation is not ordinary and necessary, consider the weaker aspects of the voluntary payment: how can a disbursement be ordinary and necessary where the payment is made even though the employer has explicitly and totally repudiated any obligation, legal or moral?

The standard corporate recitative format carefully drawn from the cases specifically casts the payment in the nominal cloak of a gift. Sometimes it is stated to have been engendered by pure donative intent or said to have been based upon affection. See *Comm'r v. Duberstein*, *supra*.

To start afresh, doesn't a gift by definition fall short of meeting the deductibility stature of a moral obligation? The categories of gift and obligation seem to be mutually exclusive. Do businesses ordinarily make gifts to employees without some degree of obligation either to the decedent or perhaps to serve the morale of other employees? If the obligation is not legally binding, is it really necessary? Ought not

to the possession of a successor.⁴¹ Income which originated from the property after death is not taxable under section 691 of the Internal Revenue Code, but under the general income sections of the code.⁴²

- (3) Whether untaxed income based on capital transactions mainly attributable to the decedent's property will be taxed or not depends on whether the decedent himself set in motion the event which generated the imposition of the tax.⁴³ Thus the unpaid capital gains tax on a completed installment sale is certainly taxable to the successor.⁴⁴ Mere accretion of

voluntary gift disbursements fall into the rule of the *Welch* case especially when the employer is often motivated to help the recipient at the expense of the government? Isn't this gift reasoning even more persuasive when the corporate employer is controlled by the same family as the recipient?

The solution to the *Reed* type disputes may lie in a challenge from the government with increased vigor as to whether a voluntary payment satisfies the ordinary and necessary tests required to sustain the employer's deduction. The service may have already laid the legal groundwork for this attack on the employer's position. Pomeroy, "Insurance and Other Fringe Benefits," 29 U. Cinc. L. Rev. 197, 220 (1960). If an employer acknowledges an obligation in order to get the deduction, it will automatically create taxability of the recipient based upon the Internal Revenue Code of 1954, § 691(a).

Perhaps the threat of another final death blow inheres in the innocuous rule that gift tax liabilities will be assessed against shareholders for gifts made by a corporation. Treas. Reg. § 25.2511-1(h)(1) (1959). If death payments in the form of gifts by the corporation are not deductible by the employer, and if they be gifts by the shareholders, can they not also be assessed as dividends to the shareholders? If corporate funds were to be distributed to shareholders and by them in turn given to a widow by the shareholders directly, two taxes would result: first, the dividend would be taxed as ordinary income when the funds are paid out by the corporation. Secondly, the transfer to the widow would be taxable as a gift. Ought the result be any different when the same effect is reached indirectly by direct payment by the corporation? Far from being a double victory, if this conclusion were to be accepted by the courts, the outcome would be instead a double defeat! To extend the possibility to the ultimate, perhaps the payment could result in an effective triple tax: the corporation might get no deduction; the shareholder might be taxed also having received a dividend; and the recipient or the shareholder might be held to a gift tax! As yet we have seen no patterns which support this astonishing possibility.

⁴¹ See table 3-2 at 356, items (n) through (y).

⁴² *Mandel v. Sturr*, 266 F.2d 321, 3 Am. Fed. Tax R.2d 1323, 59-1 U.S.T.C. ¶ 9443 (2d Cir. 1959). The significance of the distinction can lie in whether an income tax deduction for an estate tax payment is available.

⁴³ See table 3-3 at 357, items (aa) through (gg).

⁴⁴ Int. Rev. Code of 1954, § 691(a)(4); Treas. Reg. § 1.691(a)-(5) (1957); similarly if a profit results from a sale made by a successor before the death of the prior owner, the gain is taxable notwithstanding that this stepped up value is included in the decedent's estate as a gift in contemplation of death. The Internal Revenue Code of 1954, § 1014(a) ordinarily steps up basis at death, thereby effectively eliminating income tax

property value does not generate taxable income in respect of decedent⁴⁵ even though there was a binding contract fixing its value.⁴⁶ Thus the principal source of this loophole seems to be the basis provisions of section 1014 of the Internal Revenue Code.

Notions of tax equity applied to seek out otherwise untaxed income must observe the congruent limitation that no extra tax ought to be created by death. This correlative requires that comparable effective tax rate categories be applied. The statute states this result explicitly.⁴⁷ The nature of income is carried across to the decedent's successors.⁴⁸ The spread-back right to reduce bunched income by modifying the effective tax rates also applies.⁴⁹ For this same reason, the non-taxable character of an involuntary conversion reinvestment transfers from the decedent to his successor.⁵⁰

Searching out decedent's untaxed income leaves another problem for solution: the inquiry as to the taxable person and the taxable periods must be resolved. The taxable income falls on the person who has a right to receive it.⁵¹ Thus the trichotomy of devolution patterns re-enters to determine the taxable person.⁵² The executor is usually liable to pay the tax on probate estate income.⁵³ The heir in Ohio

on the proceeds except where the property was "sold, exchanged or otherwise disposed of before the decedent's death by such person . . ." who acquires the property from a decedent.

⁴⁵ Estate of Tom L. Burnett, *supra* note 34.

⁴⁶ See *supra* note 36.

⁴⁷ Capital gain is specially treated under Int. Rev. Code of 1954, § 691(a)(3). Treas. Reg. § 1.691(a)-3(b)(1) (1957); *Comm'r v. Hopkinson*, 126 F.2d 406, 28 Am. Fed. Tax R. 1349, 42-1 U.S.T.C. ¶ 9330 (2d Cir. 1942); similarly as to non taxable interest on government obligations see Treas. Reg. § 1.691(a)-3(b)(2) (1957). See also Int. Rev. Code of 1954, §§ 642(h), 652 and 662.

⁴⁸ Consider by analogy *Arrowsmith v. Comm'r*, 344 U.S. 6, 42 Am. Fed. Tax R. 649, 52-2 U.S.T.C. ¶ 9527 (1952) (expenditures by corporation shareholders after dissolution are capital losses to correspond with the capital gain treatment when the proceeds were received); *Comm'r v. Hopkinson*, *supra* note 47 and *United States v. Benedict*, 338 U.S. 692, 38 Am. Fed. Tax R. 1208, 50-1 U.S.T.C. ¶ 9179 (1950) (charitable contribution by trust limited to capital gain half includible).

⁴⁹ Estate of O'Daniel v. *Comm'r*, *supra* note 32; Treas. Reg. § 1.691(a)-3(b)(3) (1957).

⁵⁰ Estate of Goodman v. *Comm'r*, 199 F.2d 895, 42 Am. Fed. Tax R. 877, 52-2 U.S.T.C. ¶ 9556 (3d Cir. 1952), followed by Rev. Rul. 58-407, 1958-2 Cum. Bull. 404.

⁵¹ *Freuler v. Helvering*, 291 U.S. 35, 13 Am. Fed. Tax R. 834 (1934).

⁵² Unjustified allocation of income and expense between estate and beneficiary is subject to reallocation under Internal Revenue Code of 1954, § 482. *Davis v. United States*, 282 F.2d 623, 6 Am. Fed. Tax R.2d 5599 (10th Cir. 1960).

⁵³ *Randolph v. Comm'r*, 76 F.2d 472, 15 Am. Fed. Tax R. 1152, 35-1 U.S.T.C. ¶ 9169 (8th Cir.), *cert. denied*, 296 U.S. 599 (1935). For a fine discussion of these princi-

is ordinarily liable for the tax on his real estate,⁵⁴ but not where the estate has various rights amounting to ownership.⁵⁵ This is illustrated by an allocation ruling: after the estate retakes realty to pay debts, the income tax is apportioned between the heirs and the estate according to the amount used to discharge the obligation and the funds returned to the heir.⁵⁶

Once the legal right to receive income in respect of a decedent has devolved, it cannot be sold or given away⁵⁷ except at the price of precipitating the unpaid income tax liability on all of the decedent's untaxed income.⁵⁸ The only non-taxable method of transferring pregnant property short of income taxability is by transmission at death,⁵⁹ which makes it thereby subject to the federal estate tax. If income pregnant property is transferred by the estate to satisfy a pecuniary legacy, the estate realizes taxable income in respect of the decedent.⁶⁰ It can be effectively deflected by a gift to charity as a result of a testamentary direction to this effect through the interaction of the corresponding offset which results from the charitable deduction.⁶¹

ples, see especially Miller, "Federal Income Tax Problems in Probate Practice," 3 Tax Counsellors Quarterly 63 (1959), 43 Iowa L. Rev. 337 (1958); Hull, "Federal Taxation of Income From Decedent's Estates," 3 Tax Counsellors Quarterly 41 (1959); see also Lauritzen, "Estate Income During Administration—Who Owns It—Who Pays the Tax—What to Do About It?" 3 Tax Counsellors Quarterly 1 (1959).

⁵⁴ Overturf v. Dougan, 29 Ohio St. 230 (1877); "Death & Taxes I," *supra* note 20; I.T. 1596, II-1 Cum. Bull. 130 (1923); Abbot v. Welch, 31 F. Supp. 369, 24 Am. Fed. Tax R. 563, 40-1 U.S.T.C. ¶ 9245 (D. Mass. 1940). Does the new Ohio permissive real estate management statute produce a different result? Ohio Rev. Code § 2113.311 (1959). Consider a will provision to remove the descent to heirs premise. Sam S. Brown, 20 T.C. 73 (1953), *acq.*, 1953-2 Cum. Bull. 3; see *infra* note 55.

⁵⁵ Jones v. Whittington, 194 F.2d 812, 41 Am. Fed. Tax R. 864, 52-1 U.S.T.C. ¶ 9203 (10th Cir. 1952); compare Estate of B. Brasley Cohen, 8 T.C. 784 (1947) (realty under California law); Rev. Rul. 57-133, 1957-1 Cum. Bull. 200; Rev. Rul. 58-69, 1958-1 Cum. Bull. 254; Rev. Rul. 59-154, 1959-1 Cum. Bull. 160. See "Death & Taxes I," *supra* note 20.

⁵⁶ Rev. Rul. 59-375, 1959-2 Cum. Bull. 161.

⁵⁷ Robert E. Cleary, 34 T.C. 728 (1960); you can't duck the income tax on pregnant property by giving it away! Treas. Reg. § 1.691(a)-4(a) (1957); see also Irwin v. Gavit, 268 U.S. 161, 5 Am. Fed. Tax R. 5380, 1 U.S.T.C. ¶ 132 (1925).

⁵⁸ Treas. Reg. § 1.691(a)-4(a) (1957).

⁵⁹ Treas. Reg. § 1.691(a)-4(b) (1957).

⁶⁰ Comm'r v. Brinkerhoff, 168 F.2d 436, 36 Am. Fed. Tax R. 1067, 48-1 U.S.T.C. ¶ 9296 (2d Cir. 1948); Rev. Rul. 60-87, 1960-1 Cum. Bull. 198 and Rev. Rul. 55-117, 1955-1 Cum. Bull. 233.

⁶¹ Treas. Reg. § 1.642(c)-1 (1956); Estate of Clymer v. Comm'r, 221 F.2d 680, 47 Am. Fed. Tax R. 729, 55-1 U.S.T.C. ¶ 9418 (3d Cir. 1955); Drye, "Testamentary Gifts of Income to Charity," 13 Tax L. Rev. 49 (1957). This device is under congressional scrutiny.

CARRYING TO SUCCESSORS THE BENEFIT OF DEDUCTIONS UNUSED
BY THE DECEDENT DURING HIS LIFETIME

Taxing untaxed income to the decedent's successors produces its equitable correlative: if the decedent had income tax deductions unused during his lifetime, his successors ought later to get the benefit of these. This is the policy behind section 691(b) of the Internal Revenue Code. Deductions are allowed for business expenses, interest, taxes and for non-business expenses and for the foreign tax credit.⁶² A similar deduction for depletion is allowed to the income recipient.⁶³ Except for this limitation, the deductions generally descend to successors irrespective of whether there be income in respect of the decedent in the person entitled to the deduction.⁶⁴ Thus, it appears that a deduction would be allowable for interest paid by the beneficiary of an insurance policy out of which an unpaid loan was satisfied after death.⁶⁵

Of recurring interest is the continual problem of decedents' unpaid Ohio real estate tax liens: the tax becomes a lien on January 1st of each year⁶⁶ but is not collected until about fifteen to twenty months later in many Ohio counties.⁶⁷ Most Ohio decedents owning real estate die with at least two half-liens outstanding; many will owe three half-liens, and some will owe four, depending upon the time of year during which death occurs, and the promptness of the collection machinery. These liens are chargeable against the corpus of the estate as effective tax deductions quite without regard to the normal time of payment.⁶⁸ They are also deductions in respect of the decedent,⁶⁹ available to the heir in the absence of the decedent's contrary testamentary direction.⁷⁰

Deductions in respect of the decedent have their permissible counterpart in a corresponding deduction for estate tax purposes.

⁶² Int. Rev. Code of 1954, § 691(b)(1).

⁶³ Int. Rev. Code of 1954, § 691(b)(2); Treas. Reg. § 1.691(b)-1(b) (1957).

⁶⁴ Treas. Reg. § 1.691(b)-1(a) (1957).

⁶⁵ Consider Estate of Pat E. Hooks, 22 T.C. 502 (1954), *acq.*, 1955-1 Cum. Bull. 5, which is possibly distinguishable. Compare J. Simpson Dean, 35 T.C. No. 113 (1961).

⁶⁶ Ohio Rev. Code § 5719.01 (1953). Collection dates are fixed by law at December 20 and June 20 of the following year. Ohio Rev. Code § 323.12 (1953); see Ohio Rev. Code §§ 5719.17 and 5719.18 (1953).

⁶⁷ See Boehm, "Ohio Real Estate Tax Liens: Their Federal Tax Consequences," 27 U. Cinc. L. Rev. 372 (1958) for a documented discussion. See also *infra* note 76.

⁶⁸ Treas. Reg. § 20.2053-6(b) (1958); Estate of Theresa Seagrist, 42 B.T.A. 1159 (1941).

⁶⁹ Int. Rev. Code of 1954, § 691(b).

⁷⁰ Ohio Rev. Code § 2113.52 (1953) requires the heir to pay all real estate tax liens in the absence of a contrary testamentary direction. This would mean that the heir to Ohio realty gets the deduction in respect of the decedent under Internal Revenue Code of 1954, § 691(b). See also Ohio Rev. Code §§ 5719.24, 5719.25 and 5719.26 (1953).

Duplications of these deductions are permissible.⁷¹ This is not an unintended benefit⁷² but is an inevitable result of this comprehensive settlement-just-before-death reasoning.⁷³ The decedent's unused capital loss carry-overs seem to be one missing item which goes unused under any theory.⁷⁴

RECOGNITION OF EXPENDITURES AND DEDUCTIONS TO DETERMINE INTERRELATED FEDERAL INCOME AND ESTATE TAXES

We have seen that tax policy has set out to protect the federal revenues by scooping up post-mortem taxes on taxable income, previously missed as to the decedent, and that it seeks to assess an estate tax on the devolution of the property value of the income rights. In applying both objectives, one simple equitable corollary needs attention:

If the decedent had collected all his income the night before he died, had prepared his tax returns and had paid all his bills,⁷⁵ what would he have had on deposit in a bank at his death as a result? On this net amount only ought tax be levied on his estate.

This comprehensive settlement inquiry lies at the heart of a simple philosophy from which can be understood the allowance of estate tax deductions for claims against the estate, tax liens,⁷⁶ in-

⁷¹ Treas. Reg. § 1.642(g)-2 (1956); Int. Rev. Code of 1954, § 2053.

⁷² See Cox, "Executors Election to Claim Certain Deductions for Income or Estate Tax Purposes," 20 Ohio St. L.J. 23 (1959) and Frank, "Double Deductions—A Little Labyrinth," 32 Taxes 473 (1954).

⁷³ The concept has spawned an impressive group of secondary authorities: Craven, "Taxation of Income of Decedents," 102 U. Pa. L. Rev. 185 (1953); Drye, "The Taxation of a Decedents Income," 8 Tax L. Rev. 201 (1953); Irell, "Income In Respect of Decedents as Affected by the 1954 Internal Revenue Code," 1955 So. Calif. Tax Inst. 535 (1955); Kennedy, "Income Tax Problems of Decedents and Their Estates," 48 Nw. U.L. Rev. 36 (1953); Krieg & Buschmann, "Section 126: Items of Gross Income In Respect of a Decedent," 32 Taxes 651 (1954); Louthan, "Income In Respect of Decedents," 96 Trusts & Estates 236 (1957); Spaulding, "Limitations of Income In Respect of a Decedent," 18 N.Y.U. Inst. Fed. Tax. 1159 (1960); Windhorst, "Income In Respect of a Decedent," 37 Taxes 1082 (1959); Wright, "Taxation of Income In Respect of a Decedent," 31 Neb. L. Rev. 522 (1952); Note, 65 Harv. L. Rev. 1024 (1952).

⁷⁴ Rev. Rul. 54-207, 1954-1 Cum. Bull. 147.

⁷⁵ This simplified statement overlooks the tax rate problem which inheres in the possibility of bunching of income. In the form in which this query is stated, the summary has been simplified to ignore the rate factor. This aspect of the problem has been treated in a different context in the text at *infra* note 113.

⁷⁶ Real estate tax liens accrued at the date of death enforceable either in personam against the decedent or in rem against includible property are proper deductions for estate tax purposes under Internal Revenue Code of 1954, § 2053(a)4. Treas. Reg. § 20.2053-6(b) (1958); see also Treas. Reg. § 1.691(b)-1(a) (1957), quoted in part at *infra* note 78. Since Ohio real estate taxes accrue in rem on January 1 of each year

debtedness and other deductions⁷⁷ unused before the date of death. Had all of these obligations been satisfied by payment before death, cash would have declined by the amount actually paid out to satisfy the claims. Thus, the estate tax deduction for debts and expenses serves to reduce the gross estate to the correct amount of the net estate passing.

That these items should also be deductible to the estate for income tax purposes is simply a second correlative result of this suggested comprehensive settlement-just-before-death reasoning: since all income must be taxed in some way regardless of death, all deductions ought to be allowed as income tax deductions at the time of payment after death much as they would have been deductible had they been satisfied before death. Payment of debts which included disbursements for deductible expenses would have produced for the decedent some reduction in income taxes in the return for the period when they were paid.⁷⁸ The double deduction, fully justified in reason, is therefore explicitly allowed by established Treasury policy⁷⁹ as the only reasonable result attending devolution of the decedent's property:

- (1) A deduction for estate tax purposes reduces the net property value of the taxable succession to the proper net amount which would have passed and would have been taxable if the liabilities had been paid during life.

under Ohio Revised Code § 5719.01 (1953), but are collected the following year, any decedent will have at least two half-taxes, and perhaps three or four, outstanding at death depending upon the time of his passing and whether the semi-annual collections have been satisfied. For a full discussion see Boehm, *op. cit. supra* note 67.

⁷⁷ Int. Rev. Code of 1954, § 2053. Indebtedness includes enforceable personal liability of the decedent. Treas. Reg. § 20.2053-4 (1958); Treas. Reg. § 20.2053-7 (1958). Thus a binding separation agreement enforceable under state law to leave property to children is properly deductible for estate tax purposes as a claim against the estate of the decedent. *Beecher v. United States*, 280 F.2d 202, 6 Am. Fed. Tax R.2d 6113 (3d Cir. 1960).

⁷⁸ "If the decedent who reported income by use of the cash receipts and disbursements method owned real property on which accrued taxes had become a lien, and if such property passed directly to the heir of a decedent in a jurisdiction in which real property does not become a part of a decedent's estate, the heir, upon paying such taxes, may take the same deduction under section 164 that would be allowed to the decedent if, while alive, he had made such payment." Treas. Reg. § 1.691(b)-1(a) (1957).

⁷⁹ Treas. Reg. § 1.642(g)-2 (1956): The alternative deduction requirement does not apply to "deductions for taxes, interest, business expenses, and other items accrued at the date of a decedent's death so that they are allowable as a deduction under section 2053(a)(3) for estate tax purposes as claims against the estate and are also allowable under section 691(b) as deductions in respect of a decedent for income tax purposes. . . ."

- (2) At the same time, some successor has the right to claim as an income tax deduction when paid, the amount of indebtedness unused by the decedent because of non-payment during his lifetime. The expenditure is thereby made available for the living successor to the original taxpayer as an income tax deduction in respect of the decedent.

Occurrences near the end of life may span both life and death; a decedent's accrued medical expenses unpaid at death are the subject of three-way alternatives quite unlike any other:

- (1) they may be once deducted as a debt for estate tax purposes⁸⁰ as effectively reducing the value passing to successor; or
- (2) they may be alternatively deducted as expenses in the last income tax return of the decedent as though they had been satisfied before death if they were finally paid within one year after death notwithstanding that the decedent was a cash basis taxpayer;⁸¹ or
- (3) they may be alternatively deducted by the surviving spouse in her income tax return for the year in which they were actually paid.⁸²

But these three possibilities are strictly exclusionary: they may be deducted only once in total,⁸³ although they may be broken into parts with complete latitude. Thereby, they may be claimed in part for more than one purpose⁸⁴ with the only overriding limitation that the total deductions allowable cannot exceed the total amount paid.⁸⁵ The medical alternative deduction rule produces one application in which

⁸⁰ Int. Rev. Code of 1954, § 2053(a)3; Treas. Reg. § 20.2053-1(d) (1958); *Tate v. O'Malley*, 52 F. Supp. 834, 31 Am. Fed. Tax R. 1185 (W.D. Pa. 1943); *Estate of McGugan*, 47 B.T.A. 658 (1942).

⁸¹ Int. Rev. Code of 1954, § 213(d)1; the option is not available as to a closed year. Treas. Reg. § 1.213-1(d)(1) (1960).

⁸² Int. Rev. Code of 1954, § 213(a); Treas. Reg. § 1.213-1(e)-(1)(c)(3) (1960).

⁸³ Int. Rev. Code of 1954, § 213(d)2; Treas. Reg. § 1.213-1(d)(2) (1960).

⁸⁴ Consider whether Treas. Reg. § 1.642(g)-2 (1956) can be read along with Treas. Reg. § 1.213-1(d) (1960); compare also Rev. Rul. 59-32, 1959-1 Cum. Bull. 245 which holds that administration expenses not allowable for income tax purposes because they are attributable to tax free income can be divided and claimed for estate tax purposes. See also *infra* note 100.

⁸⁵ The medical deduction is a very special dispensation with a minimum amount based at 3% of adjusted gross income for a taxpayer and wife neither of whom reached 65 years of age in the taxable year. Treas. Reg. § 1.213-1(a)(2) (1960). The portion below the 3% minimum can be used as an estate tax deduction under the Internal Revenue Code of 1954, § 2053(a)(3). The portion over the 3% minimum up to the maximum amounts imposed by the Internal Revenue Code of 1954, § 213(c) could be used as an income tax deduction. The 3% rule may influence the choice as to which income tax alternative is adopted under the authority of the two contrasting methods of the Internal Revenue Code of 1954, §§ 213(d)(1) and 213(a). The possibility of a choice to use the optional standard deduction may influence one of the other alternatives. Int. Rev. Code of 1954, § 144(a). The statute does not permit the fiduciary to use the medical deduction on his income tax return for the estate.

superficially the settlement-before-death philosophy might seem not to fit: possibly—to conjecture—this reasoning is still applicable because medical expenses are personal deductions which have no essential relation to the determination of taxable economic income.⁸⁶

Death necessarily creates peculiar expenditures based upon the event itself. Funeral bills can be considered as the decedent's approximate counterpart to the personal expense of the living;⁸⁷ from this approach the basis for the rule that funeral expenses are not deductible for income tax purposes can be understood.⁸⁸ They are deductible for estate tax purposes only⁸⁹ presumably because they consume some of the value of the succession which would otherwise pass to the next generation.

After the decedent's obsequies, follows the problem of the administration of his estate. Here again because succession values are reduced, administration costs may be offset as an estate deduction⁹⁰ and similarly, perhaps for the same reason, losses and casualties "during the settlement of estates"⁹¹ are deductible for estate tax purposes.⁹²

⁸⁶ Consider the implications of the Internal Revenue Code of 1954, § 62 as to deductions made in order to determine gross income as in *Lela Sullenger*, 11 T.C. 1976 (1948); *Treas. Reg. § 1.61-3(a)* (1957) as contrasted with deductions to arrive at net income. An election to claim the optional standard deduction excludes the right to itemize medical deductions. *Treas. Reg. § 1.141-1(a)* (1957).

⁸⁷ *Int. Rev. Code of 1954*, § 262.

⁸⁸ *Estate of Orville F. Yetter*, 35 T.C. No. 82 (1961); *Rev. Rul. 56-449* as revised, 1956-2 Cum. Bull. 180.

⁸⁹ *Int. Rev. Code of 1954*, § 2053(a)(1); *Treas. Reg. § 20.2053-2* (1958); *Comm'r v. Cardeza's Estate*, 173 F.2d 19, 37 Am. Fed. Tax R. 986 (3d Cir. 1949). Even so, the funeral expense deduction explicitly turns on local law. *Blackburn v. United States*, 6 Am. Fed. Tax R.2d 6146 (S.D. Ind. 1960). *Treas. Reg. § 20.2053-2* (1958) permits deduction for the cost of a burial lot "either for the decedent or his family," but in any event, the federal deduction standard is expressly made subject to local probate law. See *Rev. Rul. 57-530*, 1957-2 Cum. Bull. 621. Distinguish the priority problem here; some funeral bills are preferred as to other creditors; the balance are general claims. Ohio law grants priority to expenses of funeral direction of \$500 and for other expenses as approved by the probate court. *Ohio Rev. Code § 2117.25(B)* (1953). The same section contemplates additional bills payable for the same purpose but denies payment priority. By statute, the husband is entitled to reimbursement from the estate of his wife for funeral expenses paid by him. *Ohio Rev. Code § 2117.26* (1953). His common law liability in his own right has not been modified. *Lee v. Hemy*, 35 Ohio App. 402, 172 N.E. 421 (1929); *Note*, 4 U. Cinc. L. Rev. 486 (1935); *Note*, 7 Ohio St. L.J. 472 (1941).

⁹⁰ *Int. Rev. Code of 1954*, §§ 2053(a)2, 2053(b); *Treas. Reg. § 20.2053-3* (1958); for an excellent discussion see *Lowndes & Kramer, Federal Estate and Gift Taxes 331-37* (1956).

⁹¹ *Int. Rev. Code of 1954*, § 2054; *Treas. Reg. § 20.2054-1* (1958).

⁹² Casualty seems to mean about the same either under the estate tax deduction *Lyman v. Comm'r*, 83 F.2d 811, 17 Am. Fed. Tax R. 1197, 36-2 U.S.T.C. ¶ 9307 (1st Cir. 1936) as under the income tax deduction provision in *Internal Revenue Code of 1954*, § 165(c)(3).

TABLE 4†
SINGLE, OPTIONAL AND DUPLICATING INCOME, DEDUCTIONS AND CREDITS
FOR DECEDENTS, ESTATES AND BENEFICIARIES

| Nature of the receipt or expenditure | Last income tax return of decedent | Estate tax return — Form 706 | Income tax return of fiduciary: Form 1041 | Income tax return of beneficiary | References and comments See key at bottom of this page |
|---|------------------------------------|------------------------------|---|----------------------------------|--|
| Expenses of last illness paid within 1 year | Alt | Alt | | D/D: if to spouse | IRC § 213(d) IRC § 2053(a) (3) IRC § 213(a), (c) (2) |
| Funeral expenses | | 1 | | | IRC § 2053(a) (1) |
| Liabilities for unpaid expenses properly charged to prior taxable periods for decedent on accrual basis | D/D | D/D | | | IRC § 2053(a) (3) |
| Alimony obligations | | 1 | | | See note a |
| Personal obligations of the decedent deductible for income tax purposes if he were alive | | 1 | | | IRC § 2053(a) (3) |

a. The commuted value of an unpaid alimony obligation may be deductible as a claim for estate tax purposes if it has been created by a binding court order, or if it arose from more than a mere separation agreement. *Regulations* § 20.2053-4(b); *Comm'r v. Estate of Watson*, 216 F.2d 941, 46 AM. FED. TAX R. 1115 (2d Cir. 1954); INT. REV. CODE OF 1954, § 2053(a) (3). See Cornick, *How Divorce and Separation Affect Estate Taxes*, LASSER'S ESTATE TAX TECHNIQUES, 67.

For income tax purposes, a divorced or separated wife is a beneficiary of the estate. INT. REV. CODE OF 1954, § 682(b); see also INT. REV. CODE OF 1954, § 7701(a) (17). Under the 1939 Code, which seems the same as the present law for this purpose, the additional fact that the estate was entitled to a deduction for the estate tax did not prevent a distribution deduction for the fiduciaries' income tax return. *Laughlin's Estate v. Comm'r*, 167 F.2d 828, 36 AM. FED. TAX R. 985 (9th Cir. 1948). The Treasury published its lengthy agreement with the result in the Laughlin case. GCM 25999, 1949 CB-1, 116, 49 PH Fed. ¶ 76263.

Since the alimony was a distributable item to the wife, it will be includible in her gross income as a beneficiary under INT. REV. CODE OF 1954, § 662(a). *Estate of Daniel G. Reid*, 15 T.C. 573 (1950), *aff'd* on other issues *sub nom. Izrastzoff v. Comm'r*, 193 F.2d 625, 41 AM. FED. TAX R. 630 (2d Cir. 1952); *Daisy M. Twinam*, 22 T.C. 83 (1954).

In effect, taken together these two rules seem to produce a deduction for both estate and fiduciary but the result is diluted by the correlative taxability to the spouse as a distributee under INT. REV. CODE OF 1954, § 662(a).

KEY TO SYMBOLS:

- 1 Includible or deductible for purposes of one return only; no alternatives or duplications are permissible.
- D/D Duplicating deduction available for two returns.
- Alt Alternative deduction which may be used for either one of two different purposes; the governing statute is usually IRC § 642(g) unless covered under another specified statutory limitation.
- C/B Carried to a beneficiary. This item may be used as a carryover deduction or inclusion if not previously used. Generally the beneficiary must carry the burden to qualify under IRC § 642(h). It may also be available if he receives income in respect of a decedent which must carry the correlative expenses which invoke IRC § 691(b).

† Table 4 is reprinted from 31 Rocky Mountain Law Review 174-77 (1959) with permission.

TABLE 4 (Continued)
SINGLE, OPTIONAL AND DUPLICATING INCOME, DEDUCTIONS AND CREDITS
FOR DECEDENTS, ESTATES AND BENEFICIARIES

| Nature of the receipt or expenditure | Last income tax return of decedent | Estate tax return — Form 706 | Income tax return of fiduciary: Form 1041 | Income tax return of beneficiary | References and comments |
|--|------------------------------------|------------------------------|---|----------------------------------|---|
| Personal exemption credit | 1 | | 1 | 1 | No carryovers |
| Decedent's unpaid income tax obligations | | 1 | | | IRC § 2053; see <i>Rev Rul 57-78</i> for joint liabilities |
| Gift tax liability | | 1 | | no | IRC § 2053; credit against estate tax due; IRC § 2012(a) |
| Capital loss | 1 | 1 | 1 | C/B | IRC § 1212; IRC § 642(h) (1); See note b |
| Charitable obligation binding during lifetime | | 1 | | | Regs § 20.2053-5 as limited in scope |
| Charitable legacy not out of income | | 1 | | | IRC § 2055 |
| Charitable bequests out of fiduciary's income | | D/D | D/D | | See note c |
| Property preservation costs | | D/D | D/D | | See note d |
| Casualty losses | | Alt | Alt | C/B* | IRC § 2054; IRC § 165(c) (3); *indirectly by net operating loss deduction |
| Net operating losses during administration of the estate | | | 1 | C/B | IRC § 162 ff, etc. IRC § 642(h) (1) Rev. Ruling 61-20 |
| Income in respect of decedent | | D/D | D/D | C/B | Included whenever received: IRC § 691(a) |
| United States "E" bond interest income | Alt | taxable | Alt | C/B | IRC § 454(a) IRC § 691(a) IRC § 2031(a) |

b. Unused capital losses cannot be carried from the decedent to the estate or to the beneficiaries. *Revenue Ruling 54-207*, 1954-1 CB 147, 1954 PH Fed. ¶ 76777; *Jones v. Whittington*, 194 F.2d 812, 41 AM. FED. TAX R. 864 (10th Cir. 1952). The decedent's property includible in the estate takes on a new basis. INT. REV. CODE OF 1954, § 1014. Capital losses sustained may be deducted by the estate or carried to the beneficiaries. *Regulations* § 1.642(h)-1(b).

c. A charitable bequest out of income only is deductible for estate tax purposes to the amount of the *present value* of the income dedicated to the charity. The disbursement is deductible to the fiduciary against income. See *Drye, Testamentary Gifts of Income to Charity*, 13 TAX L. REV. 49 (1957). The charitable deduction cannot be carried over to the ultimate beneficiary. INT. REV. CODE OF 1954, § 642(h) (2); § 642(c).

d. Whether losses in a hobby farm or business are deductible by the estate depends upon whether the property is being liquidated or preserved, or whether it is being used to serve a personal purpose of the beneficiaries. See *Estate of Mortimer B. Fuller*, 9 T.C. 1069 (1947); *Baker, Income Tax Planning for Executors*, 9 TAX L. REV. 281, 293 (1954).

TABLE 4 (Continued)
SINGLE, OPTIONAL AND DUPLICATING INCOME, DEDUCTIONS AND CREDITS
FOR DECEDENTS, ESTATES AND BENEFICIARIES

| Nature of the receipt or expenditure | Last income tax return of decedent | Estate tax return — Form 706 | Income tax return of fiduciary: Form 1041 | Income tax return of beneficiary | References and comments See key at bottom of this page |
|--|------------------------------------|------------------------------|---|----------------------------------|--|
| Deductions in respect of a decedent | | D/D | D/D | C/B | IRC § 2053(a) (4) IRC § 691(b) |
| Interest on unpaid tax obligations | | D/D | D/D | C/B | IRC § 2053 IRC § 641(b) IRC § 163 |
| Federal estate tax on income in respect of decedent | | | 1 | C/B | IRC § 691(c) on ratio basis |
| Income taxes on income received after death | no | no | no | no | IRC § 2053(c) (1) (B) |
| Selling expense for estate property | | Alt(?) D/D(?) | Alt(?) D/D(?) | C/B(?) C/B(?) | IRC § 691(c) See note e |
| Fiduciaries' fees and commission | | Alt | Alt | C/B | Usually taxable income to fiduciary <i>Rev Rul 56-472</i> |
| Administration expenses and tax determination costs | | Alt | Alt | C/B | IRC § 2053; Regs § 1.212-1(i) |
| Taxes on property passing to fiduciary for administration and control properly deductible before death under decedent's method of accounting | D/D | D/D | | | IRC § 2053(c) (1) (B) IRC § 164; see <i>Magruder v. Supplee</i> , 316 U.S. 394 (1942); and <i>Walsh-McGuire Co. v. Comm'r</i> , 97 F.2d 983 (1938) |
| Property taxes a lien | | D/D | D/D | C/B | IRC § 2053(c) (1) (B) IRC § 691(b) (1) (A) |

e. Selling expense resulting from liquidation for estate administration reasons has been held to be alternatively deductible against selling price to determine capital gain or as an estate tax deduction. *Revenue Ruling 56-43*. But under pure income tax theory, maybe it ought to be treated as an offset against selling price; under this plausible approach, it is not a deduction requiring alternative treatment. Pincus, *Expenses of Sale by Estates*, 95 TRUSTS & ESTATES 1004 (1956).

KEY TO SYMBOLS:

- 1 Includible or deductible for purposes of one return only; no alternatives or duplications are permissible.
- D/D Duplicating deduction available for two returns.
- Alt Alternative deduction which may be used for either one of two different purposes; the governing statute is usually IRC § 642(g) unless covered under another specified statutory limitation.
- C/B Carried to a beneficiary. This item may be used as a carryover deduction or inclusion if not previously used. Generally the beneficiary must carry the burden to qualify under IRC § 642(h). It may also be available if he receives income in respect of a decedent which must carry the correlative expenses which invoke IRC § 691(b).

TABLE 4 (Continued)
SINGLE, OPTIONAL AND DUPLICATING INCOME, DEDUCTIONS AND CREDITS
FOR DECEDENTS, ESTATES AND BENEFICIARIES

| Nature of the receipt or expenditure | Last income tax return of decedent | Estate tax return — Form 706 | Income tax return of fiduciary: Form 1041 | Income tax return of beneficiary | References and comments |
|--|------------------------------------|------------------------------|---|----------------------------------|--|
| Taxes on property passing directly to heirs; deductible before death under decedent's method of accounting | | D/D | D/D | C/B | See note f IRC § 691(b) (1) (B) |
| Dividends credit | | | 1 | C/B | IRC § 642(h) (2) |
| Decedent's state death tax | | credit only | | | IRC § 2011 |
| Depreciation and depletion | | | 1 | C/B | IRC § 691(b) (2) |
| Amortization of grain storage facilities | | | 1 | | Not available to successors Rev Ruling 58-191 |
| Distributions to beneficiaries from corpus or income of estate | | | 1 | C/B income as distributees | IRC § 661; § 662 They retain same nature |

f. Taxes accrued before death on property which passes directly to the heirs are not a charge against the decedent's estate under Ohio law; they follow the property and the heir or devisee assumes the burden. OHIO REV. CODE § 2113.53(F) (1953). If the fiduciary pays the taxes out of the estate on behalf of the beneficiaries, not being required to do so, he is entitled to a deduction for distributed net income. The heir is charged with distributable net income under INT. REV. CODE OF 1954, § 662(a); and at the same time gets a deduction for taxes paid. But if the will forces the fiduciary to pay the taxes, the tax is deductible by the estate under INT. REV. CODE OF 1954, § 691(b). *Revenue Ruling 58-69*, 1958-1 CB 254, 58 PH Fed. ¶ 54783. The taxes are deductible for estate tax purposes. INT. REV. CODE OF 1954, § 2053(a) (3).

By contrast, an estate is a federal taxable entity⁹³ which has its own income and expenses; all deductions generally allowable for income tax purposes are available to it.⁹⁴ Thus administration expenses,⁹⁵ losses and casualties⁹⁶ are also available as deductions

⁹³ The term "estate" as used in the federal taxing statute has been judicially construed to have been used in its ordinary sense. *Laughlin Estate v. Comm'r*, 167 F.2d 828, 36 Am. Fed. Tax R. 985, 48-1 U.S.T.C. ¶ 9263 (9th Cir. 1948). But it will be treated as though it had been terminated earlier under federal standards if it is unreasonably prolonged even though the state courts have not done so. *Treas. Reg.* § 1.641(b)-3 (1959); 6 *Mertens, Law of Federal Income Taxation*, § 36.47 (1957).

⁹⁴ *Int. Rev. Code of 1954*, § 641(b); *Treas. Reg.* §§ 1.641(a)-2, 1.641(b)-1 (1956).

⁹⁵ *Treas. Reg.* § 1.212-1(i) (1957) provides that "[r]easonable amounts paid or incurred by the fiduciary of an estate or trust on account of administration expenses, including fiduciaries' fees and expenses of litigation, which are ordinary and necessary in connection with the performance of the duties of administration are deductible under section 212, notwithstanding that the estate or trust is not engaged in trade or business,

for income tax purposes.⁹⁷ Since these are not operating deductions, they are available only for the alternative election⁹⁸ although here again, like the medical deduction,⁹⁹ they may be alternatively claimed in either estate or income tax returns with full freedom to deflect and sub-divide between the returns.¹⁰⁰ But the costs of running the decedent's house for his relatives are not administration expenses.¹⁰¹ Executor's fees and commissions can operate approximately like an optional deduction but for different reasons. Fixed and determinable commissions are prescribed by Ohio statute¹⁰² and extraordinary fees may be granted by the supervising probate court.¹⁰³ Once allowed,

except to the extent that such expenses are allocable to the production or collection of tax-exempt income. But see section 642(g) and the regulations thereunder for disallowance of such deductions to an estate where such items are allowed as a deduction under section 2053 or 2054 in computing the net estate subject to the estate tax."

⁹⁸ Treas. Reg. § 1.165-7(c) (1960): "Loss sustained by an estate. A casualty loss of property not connected with a trade or business and not incurred in any transaction entered into for profit which is sustained during the settlement of an estate shall be allowed as a deduction under sections 165(a) and 641(b) in computing the taxable income of the estate if the loss has not been allowed under section 2054 in computing the taxable estate of the decedent and if the statement has been filed in accordance with § 1.642(g)-1. See § 165(c)(3)." Rev. Rul. 55-190, 1955-1 Cum. Bull. 275.

⁹⁷ As to Ohio inheritance taxes, the Cuyahoga Probate Court has held that deductions used for federal income tax purposes cannot be claimed for the inheritance tax calculation. *In re Estate of Kilroy*, Cuyahoga Probate, # 551245 (1960), 5 Danaher, Developments in Ohio Probate and Inheritance Tax Law 31 (1961). In accord is *In re Estate of Fleisher*, Clark Probate, # 38189 (1959), 4 Danaher *supra*, at 46 (1960). The contrary position was adopted by *In re Estate of Havens*, Lake Probate [Docket 32, page 6] (1959), 4 Danaher *supra*, at 46 (1960).

⁹⁸ Int. Rev. Code of 1954, § 642(g).

⁹⁹ Int. Rev. Code of 1954, § 213(d)2; see *supra* notes 80-82.

¹⁰⁰ Treas. Reg. § 1.642(g)-2 (1956). Some expenses are not deductible for income tax purposes because they are attributable to tax free income, George N. Meissner, 8 T.C. 780 (1947). In this situation, the nondeductible portion may be claimed as an estate tax deduction under Internal Revenue Code of 1954, § 2053. Rev. Rul. 59-32, 1959-1 Cum. Bull. 245; Treas. Reg. § 1.642(g)-2 (1956); see also I.T. 4048, 1951-1 Cum. Bull. 39; Rev. Rul. 240, 1953-2 Cum. Bull. 81.

¹⁰¹ Rev. Rul. 56-604, 1956-2 Cum. Bull. 601; Sterling & Miller, "Taxable Incidence of Rent Free Occupancy," 34 Taxes 759 (1956).

¹⁰² Ohio Rev. Code § 2113.35 (1953) provides that the following fees "shall be allowed" for ordinary services. See also note 106 *infra*.

| Personal estate | Cumulative compensation | Rate applicable |
|---|----------------------------|--------------------|
| \$1,000 | \$60 | 6% |
| \$5,000 | \$260 | 4% |
| Fees are allowable on all above \$5,000 at the rate of | | 2% |

¹⁰³ Ohio Rev. Code § 2113.36 (1953).

they are taxable income to the executor¹⁰⁴ under the doctrine of constructive receipt¹⁰⁵ even though they are paid at a later time.¹⁰⁶ Furthermore, if the executor has not rejected the right to receive the commissions¹⁰⁷ or has claimed them as inheritance tax deductions,¹⁰⁸ the income is taxable to the individual.¹⁰⁹ Of course the disbursement could alternatively be an estate tax deduction.¹¹⁰ But if there is a bequest in lieu of commissions it might not be taxable to the fiduciary as income¹¹¹ in which case it is not deductible to the estate.¹¹² Overlooking the question of whether the same persons are concerned, the locus of the executor's commissions deduction behaves just like an alternative. All of the considerations which impel the choice between the two alternatives arise in determining whether the executor's fee should be claimed and allowed.

The composite application of many of those rules appears in table 4 *supra*, which summarize a series of applications of these doctrines of discretionary and double deductions.

Another practical fact remains: if the hypothesized ante-mortem settlement had been accomplished, net property values passing to successors at the date of death would have been reduced correspondingly by the amount of inter vivos income taxes paid. This assumption unrealistically ignores the income tax rate problem which would certainly have arisen as the result of bunching of income.¹¹³ The time when income is finally reduced to possession affects the income tax rate applied; and this effect is even more noticeable as more taxable

¹⁰⁴ Int. Rev. Code of 1954, § 61(a)(1).

¹⁰⁵ Treas. Reg. § 1.451-2 (1957).

¹⁰⁶ *Comm'r v. Ross*, 169 F.2d 483, 37 Am. Fed. Tax R. 193, 48-2 U.S.T.C. ¶ 9341 (1st Cir. 1948); *Nangle v. United States*, 145 F. Supp. 900, 50 Am. Fed. Tax R. 854, 56-2 U.S.T.C. ¶ 10,024 (Ct. Cl. 1956).

¹⁰⁷ Rev. Rul. 56-472, 1956-2 Cum. Bull. 21; an executor's waiver of his right to commissions exercised before he is entitled to them is not a taxable gift.

¹⁰⁸ Compare Rev. Rul. 56-472, *supra* note 107 as to this point.

¹⁰⁹ If the bequest was bestowed on the condition that the executor perform the services it is taxable income. *Ream v. Bowers*, 22 F.2d 465, 6 Am. Fed. Tax R. 7053, 1 U.S.T.C. ¶ 257 (2d Cir. 1927); *Rose v. Grant*, 39 F.2d 338, 8 Am. Fed. Tax R. 10496 (5th Cir. 1930).

¹¹⁰ Treas. Reg. § 20.2053-3(b) (1958); *Comm'r v. Bornson*, 32 F.2d 112, 7 Am. Fed. Tax R. 8686, 1 U.S.T.C. ¶ 379 (8th Cir. 1929).

¹¹¹ Where the sole condition was qualification as executor, the payment was held to be a gift and was thereby not taxable. *United States v. Merriam*, 263 U.S. 179, 4 Am. Fed. Tax R. 3673, 1 U.S.T.C. ¶ 84 (1923); *Bank of New York v. Helvering*, 132 F.2d 773, 30 Am. Fed. Tax R. 684 (2d Cir. 1943); Rev. Rul. 57-398, 1957 Cum. Bull. 93.

¹¹² Treas. Reg. § 20.2053-3(b)(2) (1958).

¹¹³ Consider the court's dictum in *Comm'r v. Linde*, 213 F.2d 1, 45 Am. Fed. Tax R. 1522, 54-1 U.S.T.C. ¶ 9384 (9th Cir.), *cert. denied*, 348 U.S. 871 (1954), noted in 33 Taxes 675 (1955).

persons are introduced by reason of devolution to proliferates following the fact of death. To correctly fix the ultimate locus of the income right so as to reduce the value of the succession by the amount of the attendant income tax liability traced under section 691(a) of the Internal Revenue Code of 1954 would keep open for long periods of time the determination of estate tax liability. This is an unacceptable result since taxation is a practical matter.¹¹⁴ For this good reason, estate tax consequences cannot be directly adjusted as of the moment of death to reflect the correct amount of income tax liability on the future taxable income buried in income-pregnant assets.¹¹⁵

To provide partial relief, an income tax deduction is granted for the year in which the income was received for the proportion of the estate tax cost—perhaps two or more costs¹¹⁶—generated by the untaxed income included in the gross estate.¹¹⁷ This method permits closing the estate tax return by utilizing the inherent recurring flexibility of the annual income tax return, and the flexibility of the taxable person who receives the income right. The comparative income tax cost of this treatment could never be the same as the income tax debt which would follow from our assumed comprehensive settlement before death. Only an approach to rough justice is possible by effective reduction of the amount of taxable income to some successor of the decedent¹¹⁸ through allowance of an often inadequate proportionate offset based on the estate tax paid.¹¹⁹

¹¹⁴ We have here applied as to a legislative policy decision the dictum of Justices Peckham, McReynolds, Sutherland and Black, "Death & Taxes I," *supra* note 1.

¹¹⁵ Income in respect of a decedent is taxed at full value in the estate unreduced by the income tax imposed in effect by the Internal Revenue Code of 1954, § 691(a). Consider *Hess v. Comm'r*, 271 F.2d 104, 4 Am. Fed. Tax R.2d 5638, 59-2 U.S.T.C. ¶ 9714 (3d Cir. 1959).

¹¹⁶ Two or more estate taxes can be used as income tax deductions on the same item. Treas. Reg. § 1.691(c)-1(b), § 1.691(c)-1(d), example (2) (1957); Edna S. Ullman, 34 T.C. No. 114 (1960).

¹¹⁷ Int. Rev. Code of 1954, § 691(c). Garrity, "Income in Respect of a Decedent," 9 Kan. L. Rev. 40 (1960) is mostly concerned with the income tax deduction for estate taxes paid on pregnant property.

¹¹⁸ The deduction operates in effect as a direct offset to the taxable income. "Income in respect of a decedent shall be included in the gross income for the taxable year when received. . . ." Treas. Reg. § 1.691(a)-2(a) (1957). A deduction in respect of a decedent is allowable when paid by the estate or where there is no estate liability, when the successor acquires property subject to the lien of the deductible expense. Treas. Reg. § 1.691(b)-1(a) (1957). The income tax deduction follows the gross income inclusion above for its deductibility. Treas. Reg. § 1.691(c)-1(a) (1957). Apparently it is allowable in addition to the optional standard deduction. Compare the unavailability of the option under Internal Revenue Code of 1954, § 142(b)(4) with Treas. Reg. § 1.691(c)-2 (1957).

¹¹⁹ Consider the halving effect on the income tax deduction for estate taxes paid

The interrelationship of the two taxes can be simply stated: if there be sufficient taxable income against which the income tax deduction can be properly offset, it will usually produce tax economy to waive estate tax deductibility where the choice is required.¹²⁰ This summary of the utility of comparative deductibility between the two taxes will many times require a consideration of the methods by which the deductions are carried to various taxable persons.

COMPARING THE RELATIVE COSTS OF ALTERNATIVE DEDUCTIONS FOR INCOME TAX AND ESTATE TAX PURPOSES

The comparative money cost of the alternative deductibles for the income tax election as contrasted with the estate tax choice can be reduced to two simple mathematical propositions:¹²¹

Where the maximum marital deduction is not available, assuming sufficient offsetting otherwise taxable net income, in any net estate up to \$100,000 in value, it is always less expensive to use expenses for income tax purposes than as estate tax deductions.

Where the facts indicate that income from the estate or its assets will be taxable to some successor, we can intelligently determine the comparative effective tax costs of the two methods. Any taxable ordinary net income at all will be taxed at not less than 20 per cent.¹²² The lower income tax brackets for estate and unmarried persons are only \$2,000 wide. At the lowest brackets, after exemptions on a deduction of \$10,000 the average income tax saved to fiduciary or an unmarried person is at a rate of 26.4 per cent. In comparing the applicable levy saved the tax structure particularly exempts any net which does not exceed \$60,000.¹²³ Estate tax rates do not pass 20 per cent until the taxable estate left after the exemption exceeds \$40,000.¹²⁴

These elements prove the \$100,000 break-through proposition. In many instances property of more than \$100,000 in value will often throw off enough income to force comparisons at rates in excess of

if the pregnant property passes under the marital deduction. Estate of Thomas A. Desmond, 13 CCH Tax Ct. Mem. 889, 23 P-H Tax Ct. Mem. 833 (dictum); Rev. Rul. 55-225, 1955-1 Cum. Bull. 460; Drye, "The Taxation of a Decedent's Income," 8 Tax L. Rev. 201, 214 (1953); see also *infra* note 120.

¹²⁰ See text *infra* from notes 121-44.

¹²¹ This section is a condensation of an earlier article, Boehm, "Comparing the Relative Tax Costs of Alternative Treatment of Estate and Income Deductions and Valuation Adjustments," 31 Rocky Mt. L. Rev. 172 (1959), 9 Monthly Digest of Tax Articles 55 (1959).

¹²² The dividends received credit which in effect reduces the applicable income tax bracket by 4% is ignored. Int. Rev. Code of 1954, § 34.

¹²³ Int. Rev. Code of 1954, § 2052.

¹²⁴ Int. Rev. Code of 1954, § 2001.

the minimum which was assumed. The breaking point comparison would be raised accordingly.

Many cases will involve the additional element of the maximum permissible marital deduction either by a formula or by excessive qualification. In the full marital deduction case, the second thumb rule can be stated with precision:

Where the maximum marital deduction is available in an estate, assuming sufficient offsetting otherwise taxable net income, in any full marital deduction estate up to \$2,000,000, it is always less expensive taxwise to use expenses for income tax purposes in preference to estate tax deductibility. In most estates, the breaking point may easily pass \$4,000,000.

Where the maximum permissible marital deduction is available, as in a formula case, the elimination of an expense alternatively deductible increases the adjusted gross estate¹²⁵ by the full amount transferred to the income return. As a correlative the potential marital deduction is increased by one-half of the amount by which the adjusted gross estate has been increased through the elimination of the deduction used for income offset.¹²⁶ The effect of the full marital deduction¹²⁷ is to split into two halves the amount added to the

¹²⁵ Adjusted gross estate is the statutory term which fixes the base from which the maximum marital deduction is computed. Int. Rev. Code of 1954, § 2056(c)(2)(A). The marital deduction shall not exceed 50% of the value of the adjusted gross estate. Int. Rev. Code of 1954, § 2056(c)(1). The entire value of the gross taxable estate is reduced by the "deductions allowed by sections 2053 and 2054." Int. Rev. Code of 1954, § 2056(c)(2)(A).

¹²⁶ Rev. Rul. 55-643, 1955-2 Cum. Bull. 386.

¹²⁷ This discussion assumes a qualified marital succession which equals or exceeds the maximum allowable marital deduction, as in the case of a marital succession which over qualifies. Alternatively, a formula type marital deduction clause which may be increased by operation of the election in order to produce the largest possible marital deduction is assumed. Int. Rev. Code of 1954, § 2056(c)(1). For an example of a formula type at work in the presence of alternative deductions, see Rev. Rul. 55-643, 1955-2 Cum. Bull. 386. The deduction cannot exceed the value of all interests in property which passed from the decedent to the surviving spouse to the extent that the interest is included in the gross estate. Int. Rev. Code of 1954, § 2056(a). The use of the income tax alternative for deduction of expenses which otherwise attach to the estate does not increase the dollar value of the qualified items which pass to the surviving spouse. Rev. Rul. 55-225, 1955-1 Cum. Bull. 460. See also *infra* note 136.

Stated in composite form, the transfer of alternative deductions out of the estate tax computations increases the potential maximum marital deduction by increasing the adjusted gross estate. Rev. Rul. 55-643, 1955-2 Cum. Bull. 386. But the deduction can't exceed the value of the specific items which pass to the spouse. The alternative deduction does not change this fundamental factor. The double limitation still applies the use of an optional deduction for other than estate tax purposes but does not increase the marital deduction except where the permissible maximum is determined by reference to the adjusted gross estate limitation. Conversely, if the applicable limitation is based

estate tax base through the transfer of the deduction for income tax use. One half increases the net taxable estate; the other is neutral since it is offset by the increased maximum marital deduction. Against the diminished amount after it has been halved by the marital deduction, the full ordinary estate tax rate would be applied.

Look at a variation of the equation: algebraically, if the dollar amount of the deduction shifted from one tax base to the other is left as a constant, the equivalent mathematical result can be produced only by halving the applicable estate tax rate. In the presence of the marital deduction it will be seen that the nominal rates in operation are twice the actual effective rate. Stated inversely, *where a full marital deduction is available in an estate tax return, the estate tax cost of waiving a deduction or of increasing a valuation is one-half of the nominal effective rate.*

To determine the significance of this proposition by comparison, from inspection it can be seen that the nominal top estate tax rate for a net estate of \$2,000,000 is 45 per cent. In most marital deduction cases of this size, a reduction factor of 5.6 per cent arises from the allowable credit for state death taxes paid.¹²⁸ Combining these two elements into one stated factor, the resulting nominal net estate tax rate is 39.4 per cent. Algebraically, to determine the actual effective rate, it is necessary to divide by two the rate applicable to the transferred deduction because of the assumed presence of the maximum marital deduction factor. This done, the effective estate tax cost on an estate of \$2,000,000 is 19.7 per cent which is applicable to the face value of the items transferred for alternative use in the income tax return.

This effective estate tax rate having been deduced to be 19.7 per cent, the minimum income tax rate never can be less than 20 per cent in the presence of taxable ordinary net income assumed to be sufficient to support the amount of the deduction transferred under the optional treatment. *Quod erat demonstrandum.* The following rule of thumb can therefore be confidently applied:

In any full marital deduction estate which does not exceed \$2,000,000, it is a mathematical certainty that instead of being used for estate tax purposes a deduction can be taken more economically

upon the amount of the inheritance, the algebraic halving of rates is not effective and the thumb rule applicable is the simple statement which assumes no marital deduction at all. See *infra* note 136.

¹²⁸ To determine the rate of the credit for state death taxes paid, the marital deduction effectively halves the estate brackets applicable. The assumed two million dollar estate is thereby cut to one million. The rate of the maximum allowable credit for an estate between \$840,000 and \$1,040,000 is 5.6%. Int. Rev. Code of 1954, § 2011(b).

in a related income tax return if there is sufficient otherwise taxable ordinary net income to use up the amounts transferred under the alternative.

Even this thumb rule probably does not say enough. It is a reasonable guess that in most cases involving estates of at least \$2,000,000 in taxable value, it is reasonable to expect to find significant amounts of taxable income which might probably effectively invoke income tax brackets of several times the minimum income tax of 20 per cent which has been used as a point of departure in this analysis. Extrapolated further, a deduction lost by an estate of \$4,000,000 will generate an effective estate tax of only a little over 25 per cent. Remembering the probabilities of taxable income which seem likely to follow from large aggregations of wealth, it will be an uncommon situation indeed where it is not wise to adopt the income alternative.

This reasoning will fit a choice whether to waive fiduciary fees¹²⁹ and a proposal to increase fair market values in the gross estate¹³⁰ when the boost will raise the basis for depreciation under sections 1014 and 167(f) of the Internal Revenue Code of 1954. A stated amount of estate valuation increase will produce additional net taxable estate by only 50 per cent because the maximum marital deduction will consume the other half. The depreciation base for the ordinary income tax deduction for depreciation by the fiduciary or the beneficiaries will go up by the full amount of the increased valuation.¹³¹ Likewise

¹²⁹ Where an executor's commission is paid as compensation, it is taxable income to him. If the fiduciary is also the beneficiary, terminology may mean the difference between paying an income tax on the fee and saving an estate tax on a legacy in an identical amount. In this case, the same monetary alternative is cast in a different legal form.

If accomplished by will a legacy to an executor may avoid income tax if it does not require him to do more than qualify as a condition to receiving the legacy. *United States v. Merriam*, *supra* note 111; Rev. Rul. 57-398, 1957-2 Cum. Bull. 93. A similar result may be accomplished by a timely and unequivocal waiver by the fiduciary. Rev. Rul. 56-472, 1956-2 Cum. Bull. 21. While avoiding income tax, this alternative increases the taxable estate and boosts the estate tax on the succession as increased by the fee waived by the fiduciary.

¹³⁰ This issue could come up in a dispute with the Internal Revenue Service over the appropriate fair market value of a decedent's includible real estate. Or it could come up in deciding whether to elect to use the optional valuation date under the Internal Revenue Code of 1954, § 2032; the valuation option is available as a matter of right in any estate in excess of \$60,000 whether values have decreased or increased. Rev. Rul. 55-333, 1955-1 Cum. Bull. 449; Rev. Rul. 56-60, 1956-1 Cum. Bull. 443.

¹³¹ One conceivable limited objection has been laid to rest; the Treasury has ruled that the election to transfer administration expenses to the income tax return does not reduce the limited amounts which may receive special non-dividend treatment as distributions in redemption of stock in a closely held corporation. The funds bailed out can be used to the full amount used for succession taxes and funeral expenses. Ad-

it illustrates why income pregnant property ought not to be passed to the widow as an element in the marital deduction if another alternative can be included.¹³²

The chargeable burden of the estate and inheritance taxes¹³³ may reduce the amount passing to the widow¹³⁴ to less than the maximum permissible deduction.¹³⁵ This is obviously not a true case of an allowable maximum.¹³⁶ The calculation will fall under thumb rule no. 1. Granted a will where the property which actually passes to the surviving spouse will reach or exceed the 50 per cent maximum allowable, when deductions are transferred for alternative income tax treatment, the amount of the marital deduction will permissibly increase accordingly.¹³⁷ This will also mean by its terms that the spouse will receive a preference through the reduced charge against her share if

ministration expenses may be deducted under the alternative income tax treatment without affecting the right to claim the special tax treatment. The permissive redemption statute allows a partial distribution to the extent of all stated expenditures allowable as a deduction under the Internal Revenue Code of 1954, §§ 303(a), 2053; Rev. Rul. 56-449, 1956-2 Cum. Bull. 180.

¹³² The presence of the maximum marital deduction reduces the effective estate tax to 50% levied on the taxable succession. When the income pregnant property passes to the widow, the effective tax reduction is reduced so that the income tax deduction for the estate tax paid is diminished. See citations at *supra* note 119; Treas. Reg. § 1.691(c)-1(d)(2) (1957).

¹³³ The widow's share will be reduced by the burden of Ohio inheritance and federal estate taxes unless the will has provided otherwise. *Campbell v. Lloyd*, 162 Ohio St. 203, 122 N.E.2d 695 (1954), *cert. denied*, 349 U.S. 911 (1955); *Estate of Rose G. Jaeger*, 27 T.C. 863 (1957), *aff'd per curiam*, 252 F.2d 790 (6th Cir. 1958).

¹³⁴ Int. Rev. Code of 1954, § 2056(b)(4); Treas. Reg. § 20.2056(b)-4(c) (1958).

¹³⁵ Int. Rev. Code of 1954, § 2056(c)(1).

¹³⁶ Two recent cases which involve the effect of the alternative deduction of expenses on the computation of the marital deduction [*Estate of Roney*, 33 T.C. 801 (1960)] and the charitable deduction [*Estate of Luehrman v. Comm'r*, 7 Am. Fed. Tax R.2d 145545 (8th Cir. 1961), *affirming* 33 T.C. 277 (1960), noted in 7 U.C.L.A.L. Rev. 553 (1960)] affect the computation of the amount passing to the surviving spouse. The amount of the maximum marital deduction is fixed at 50% of the adjusted gross estate by the Internal Revenue Code of 1954, § 2056(c)(1); but there is no maximum for the charitable deduction. But the other limitation shared in common by both marital and charitable deduction definitions is fixed at the "value of any interest in property which passes or has passed to his surviving spouse" or to charity out of the gross estate. Int. Rev. Code of 1954, §§ 2055(a) and 2056(a). Both *Roney* and *Luehrman* dealt with the amount passing: thus the expenses paid out of the estate but charged to the income tax return do not necessarily increase the amount of property passing to the spouse or to the charity out of the residue. For that reason, these cases held that the two respective deductions are not increased. See Int. Rev. Code of 1954, § 2056(b)(4). See also *supra* note 127.

¹³⁷ Rev. Rul. 55-225, 1955-1 Cum. Bull. 460; Rev. Rul. 55-643, 1955-1 Cum. Bull. 386.

the income tax alternative is elected.¹³⁸ To elect this method may set up choices by the executor in favor of the widow as against other heirs or remaindermen.¹³⁹ The presence of a preference may indicate the wisdom of a will provision which authorizes full discretion in electing between the alternatives and requires no contribution to adjust for the preference.¹⁴⁰

There is little administrative burden in claiming the benefit of the alternative deductions. To justify allowance of the deductions for income tax purposes, the executor must file in duplicate a statement to the effect that the items have not been allowed as estate tax deductions. The statement must include a waiver of the right to claim the deductions for estate tax purposes.¹⁴¹ It may be filed at any time

¹³⁸ The preferences to the widow will result from the decrease in the expenses otherwise chargeable against her share and by the resulting increase in the income earned. Int. Rev. Code of 1954, §§ 2056(b)(5), 2056(b)(6). See a detailed explanation and a table illustrating the application of this problem by Polasky, "Estate Tax Marital Deduction In Estate Planning," 3 Tax Counsellors Quarterly 1 (1959).

¹³⁹ Using either tax alternative may shift property values from one beneficiary to another. To transfer administration expenses to an income tax return increases the estate tax which is levied on the corpus while it saves income taxes to the income beneficiaries. In a good reported example, a will used a marital deduction formula type clause. *In re Levy's Estate*, 167 N.Y.S.2d 16 (Surr. Ct. 1957). The fiduciary used the income tax alternative which saved federal income taxes but increased estate taxes assessed against the corpus. The court required the income beneficiary to reimburse the corpus for the estate tax cost created by the election used. Even so, the income beneficiary was still ahead by the profit which resulted from the rate spread between the two taxes. In effect, the tax tail wags the property dog; a choice for tax purposes counters a property right which would ordinarily act in opposition. Which to choose? The fiduciary ordinarily cannot prefer one beneficiary over another, and he is under a duty to save taxes. These pulls and hauls have caused fiduciaries some anxious moments. See *In re Estate of Bixby*, 140 Cal. App. 2d 326, 295 P.2d 68 (1956), noted in 4 U.C.L.A.L. Rev. 111 (1956); *In re Warms Estate*, 140 N.Y.S.2d 169 (Surr. Ct. 1955); and as to a capital gain tax transferred between corpus and income, compare *Rice Estate*, 8 Pa. D. & C.2d 379 (Orphans' Ct. 1956). The best treatment of this emerging problem appears in Gradwohl, "Current Issues In Probate Estate Income Tax Allocation," 37 Neb. L. Rev. 329 (1958). See also *In re Estate of Inman*, 22 Misc. 2d 573, 196 N.Y.S.2d 369 (Surr. Ct. 1959); and *In re Estate of McFarnahan*, N.Y.L.J. 13 (N.Y. Surr. Ct. April 25, 1960). See also the excellent collection of authorities by Polasky, *op. cit. supra* note 138, at 11-17.

¹⁴⁰ For a full suggested will provision to cover this point, see Polster, "Provisions of Wills Affecting Estate Administration and Their Tax Consequences," 20 Ohio St. L.J. 36, 41 (1959). Another short clause was suggested by Fleming, "Will Clauses to Avoid Six Estate Administration Problems," 99 Trusts & Estates 624 (1960).

¹⁴¹ Treas. Reg. § 1.642(g)-1 (1956) "Disallowance of Double Deductions; in General. Amounts allowable under § 2053(a)(2) (relating to administration expenses) or under § 2054 (relating to losses during administration) as deductions in computing the taxable estate of a decedent are not allowed as deductions in computing the taxable income of the estate unless there is filed a statement, in duplicate, to the effect that the items have not been allowed as deductions from the gross estate of the decedent under § 2053

while the limitation period is open.¹⁴² Even though a deduction has been once claimed for estate tax purposes, at the price of paying the resulting estate tax deficiency, it can still be claimed for income tax purposes so long as the estate tax deduction has not been finally allowed and the statement is filed. Once the statement for the estate tax deduction has been filed, because of the waiver, it cannot later be allowed.¹⁴³ A similar procedure is required for alternative deduction of medical expenses.¹⁴⁴

These propositions demonstrate that almost all smaller estates and many larger ones will probably justify the choice of the income tax deduction alternative in preference to reducing the size of the net taxable estate.

FEDERAL INCOME TAX DEVICES TO DEFLECT TAXABLE INCOME AND
DEDUCTIONS OF DECEDENTS AND ESTATES AMONG SUCCESSOR
TAXABLE ENTITIES

In its application of varying doctrines of devolution, property law has provided a complicated pattern for determining the entity to which flows the right to income and the responsibility for its resulting taxes. Congruently, it has assigned liability for the payment of obligations and has conferred as a correlative the right to claim the benefit of the unused deductibles. But the doctrines must work both ways; entity doctrines frustrate economic equity if they do not operatively permit corresponding tax benefit to those who bear the economic burdens of succession and its incidents. This possibility of injustice can be summarized in a general epigrammatic truism of tax economics:

or § 2054 and that all rights to have such items allowed at any time as deductions under § 2053 or § 2054 are waived. The statement should be filed with the return for the year for which the items are claimed as deductions or with the district director of internal revenue for the internal revenue district in which the return was filed, for association with the return. The statement may be filed at any time before the expiration of the statutory period of limitation applicable to the taxable year for which the deduction is sought."

¹⁴² Rev. Rul. 58-484, 1958-2 Cum. Bull. 363.

¹⁴³ Treas. Reg. § 1.642(g)-1 (1956).

¹⁴⁴ Treas. Reg. § 1.213-1(d)(2) (1957): "The rule prescribed in subparagraph (1) of this paragraph shall not apply where the amount so paid is allowable under § 2053 as a deduction in computing the taxable estate of the decedent unless there is filed in duplicate (i) a statement that such amount has not been allowed as a deduction under § 2053 in computing the taxable estate of the decedent and (ii) a waiver of the right to have such amount allowed at any time as a deduction under § 2053. The statement and waiver shall be filed with or for association with the return, amended return, or claim for credit or refund for the decedent for any taxable year for which such an amount is claimed as a deduction."

An allowable exemption or deduction is always lost and is thereby worthless unless there be available sufficient taxable net income to support the use of the income tax deduction, or alternatively unless there be a taxable net estate sufficient to consume the estate tax deduction.

Thus, for example, when rigidly applied according to concept¹⁴⁵ without regard to financial reality in an income tax return which taxes at a higher rate or which shows less income than its permissible deductions and exemptions,¹⁴⁶ the tax economy implicit in an allowable income tax deduction is lost. Some relief results where the value can be utilized for some other purpose such as for estate tax benefits¹⁴⁷ or by permitting it to be carried across to another taxable entity.¹⁴⁸

The income and expense in respect of decedent¹⁴⁹ device contains an inherently flexible solution to many of the problems of the taxable entity. The concept runs across a wide selection of persons and entities with ease: wherever income falls, in the estate of the decedent,¹⁵⁰ or to a non-probate successor,¹⁵¹ or to a distributee of an

¹⁴⁵ An estate fiduciary cannot personally deduct attorneys' fees and other administration costs on his personal return; they may be deducted only by the estate. Rev. Rul. 55-190, 1955-1 Cum. Bull. 275. From a similar conceptual compartmentalization, an estate tax deduction is disallowed for gift tax liability litigation costs when the transferees were defending their own gift tax liability as to a 1952 death, *Hoover v. United States*, 180 F. Supp. 601, 5 Am. Fed. Tax R.2d 1848, 60-1 U.S.T.C. ¶ 11,923 (Ct. Cl. 1960) although the effect of this decision may have been modified by the enactment of the Internal Revenue Code of 1954, § 212(3). Consider also *Bonnyman v. United States*, 156 F. Supp. 625, 52 Am. Fed. Tax R. 948, 57-2 U.S.T.C. ¶ 9938 (E.D. Tenn. 1957), *aff'd*, 261 F.2d 835, 3 Am. Fed. Tax R.2d 380 (6th Cir. 1958). 6 Mertens, *op. cit. supra* note 93, at §§ 36.18, 36.28.

¹⁴⁶ Conscious attempts to deflect income thereby to avoid the extra cost resulting from higher brackets (consider the examples suggested at *supra* note 63) can be compared to a slightly more sophisticated device by which deductions are deflected to high bracket tax payers to accomplish the same objective. Among a myriad of examples see *Farnsworth v. Comm'r*, 270 F.2d 660, 4 Am. Fed. Tax R.2d 5624, 59-2 U.S.T.C. ¶ 9705 (3d Cir. 1959); *Colston v. Burnet*, 59 F.2d 687, 11 Am. Fed. Tax R. 606, 3 U.S.T.C. ¶ 947 (D.C. Cir.), *cert. denied*, 287 U.S. 640 (1933); *United States v. Shafter*, 246 F.2d 338, 51 Am. Fed. Tax R. 870, 57-2 U.S.T.C. ¶ 9859 (4th Cir. 1957).

¹⁴⁷ Int. Rev. Code of 1954, §§ 642(g), 2053, 2054.

¹⁴⁸ The taxable entity approach is usually applied with rather technical overtones to prevent jumping deductions from one taxpayer to another. See *supra* note 146; see also as to officers salaries for corporate employers, *Noland v. Comm'r*, 269 F.2d 103, 4 Am. Fed. Tax R.2d 5031, 59-2 U.S.T.C. ¶ 9600 (4th Cir.), *cert. denied*, 361 U.S. 885 (1959); *Leedy-Glover Realty & Ins. Co.*, 13 T.C. 95 (1949), *aff'd*, 184 F.2d 883 (5th Cir. 1950).

¹⁴⁹ Int. Rev. Code of 1954, §§ 691(a), 691(b).

¹⁵⁰ Int. Rev. Code of 1954, § 691(a)(1)(A).

¹⁵¹ The Internal Revenue Code of 1954, § 691(a)(1)(B), taxes income in respect of a decedent to "the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the

estate,¹⁵² the income is taxable when received or deductible when the obligations are paid.¹⁵³ Striding across the years and jumping onto various taxable entities and persons at the same time, the method seems very nearly free of the conceptual difficulties implied in the taxable person question tied up in ordinary income tax law: To whom was the income taxable?¹⁵⁴

In the administration of an estate, if income is once present and taxable,¹⁵⁵ by applying the distributable net income concept,¹⁵⁶ income can be held in the estate to produce tax or be deflected to transfer it. Taxable income is transferred to beneficiaries by the distribution process.¹⁵⁷ This permits conscious conduct flexibly designed solely for tax economy. Conversely, it can produce a deflection of income tax liability by accident or misinformation.¹⁵⁸ Distribution has its

decendent's estate from the decedent." Treas. Reg. § 1.691(a)-2(b), example (3) (1957) illustrates this situation with pregnant survivorship government E bonds.

¹⁵² Int. Rev. Code of 1954, § 691(a)(1)(c) covers the distributee from an estate if the income right was distributed. See Treas. Reg. § 1.691(a)-2(b), examples (1) and (2) (1957).

¹⁵³ The broad scope of the inclusion spelled out by the Internal Revenue Code of 1954, § 691(a), would seem to include all of the heirs and next of kin usually covered by the statutes of descent and distribution. Suppose that a pregnant property arrangement were effectively made payable to a remote third party, such as a paramour. This broad code provision would surely hold any distributee liable for the income tax. Could it be any different if the recipient were a paramour? Situations looking like this don't seem to get into the reports. In a different connection, see Leon Turnipseed, 27 T.C. 758 (1957); and consider Hugh B. Monjar, 13 T.C. 587 (1949), *acq.*, 1950-1 Cum. Bull. 3.

¹⁵⁴ The "to whom" question is at the heart of much federal income tax doctrine. *McCaughn v. Girard Trust Co.*, 19 F.2d 218, 6 Am. Fed. Tax R. 6687 (3d Cir. 1927).

¹⁵⁵ See *infra* notes 156 and 158 developing the prime requisite that taxable income must be present apart from the mechanical activity of administering and distributing the estate.

¹⁵⁶ The Internal Revenue Code of 1954, § 643(a) reverses the result in *Johnson v. Helvering*, 141 F.2d 208, 32 Am. Fed. Tax R. 280, 44-1 U.S.T.C. ¶ 9215 (2d Cir.) *cert. denied*, 323 U.S. 715 (1944) and *McCullough v. Comm'r*, 153 F.2d 345, 34 Am. Fed. Tax R. 866, 46-1 U.S.T.C. ¶ 9140 (2d Cir. 1946). See *Davidson v. United States*, 149 F. Supp. 208, 50 Am. Fed. Tax R. 1948, 57-1 U.S.T.C. ¶ 9462 (Ct. Cl. 1957).

¹⁵⁷ The Internal Revenue Code of 1954, § 661(a) grants a deduction to the estate for all amounts distributed to the beneficiaries during the year up to the amount of the distributable net income. The amounts so passed to the beneficiaries are taxed to them under the Internal Revenue Code of 1954, § 662(a).

¹⁵⁸ The distribution will carry taxable income to the beneficiaries dependent upon (1) the presence of taxable income (2) the distribution of value and (3) the absence of testamentary direction or equivalent legal devolution device included under the Internal Revenue Code of 1954, § 663. Casner, "Tax Results of Interim Estate Distributions," 98 Trusts & Estates 200 (1959). These circumstances deflect income regardless of intent and whether or not a capital item was the basis of the value distributed. See *supra* note 156 and S. Rep. No. 1622, 83d Cong., 2d Sess. 346 (1954).

own special meaning and effect. At the time local law or the governing instrument requires a distribution, its fair market value is treated as taxable income carried over to the successor as distributable net income.¹⁵⁹ The same result follows from an indirect distribution¹⁶⁰ or when the distribution is accomplished without a specified requirement.¹⁶¹ The character of the income is preserved.¹⁶² Since qualified marital deduction trusts require that income must be distributed annually or more frequently commencing not later than thirteen months after death,¹⁶³ it would seem that this requirement of property rights passing or distributable to the widow would carry distributable net income to her under the requirement test. The distributions destroy the right to use the estate's statutory deduction of \$600¹⁶⁴ if they exceed the otherwise taxable income.¹⁶⁵ The distributions are not affected by the throw-back rule which applies only to trusts but not to an estate.¹⁶⁶ Not all distributions out of the estate are treated as taxable net income. Distributions of a specific sum of money or specific property payable in not more than three instalments do not carry income to the beneficiary.¹⁶⁷ Nor do payments to satisfy the widow's

¹⁵⁹ Int. Rev. Code of 1954, § 661(a)(1).

¹⁶⁰ An indirect distribution where assets are used to discharge a legal obligation is also treated as distributable net income. Treas. Reg. § 1.661(a)-2(d) (1956); Treas. Reg. § 1.662(a)-4 (1956).

¹⁶¹ Int. Rev. Code of 1954, § 661(a)(2). This seems comparable to a corporate dividend which requires no tracing to carry income; the required presence of distributable net income is the equivalent of corporate earnings and profits. Int. Rev. Code of 1954, § 3316(2). This distribution also covers non specific capital distributions in kind. Treas. Reg. § 1.662(a)-3(b) (1956). Proposed legislation which was nearly enacted early in 1960 will change this result for most property distributions in kind within 3 years of death. H.R. 9662, 86th Cong., 2d Sess. (1960), proposed § 663(a)(2) of the Internal Revenue Code.

¹⁶² The same character of income distributed or held is preserved whether it be taxable in the estate or in the hands of beneficiaries. Treas. Reg. § 1.662(b)-1 and 2 (1956). Capital gains and losses keep their nature. Int. Rev. Code of 1954, § 643(a)(3); so does the dividend exclusion, Int. Rev. Code of 1954, § 643(a)(7); tax exempt interest, Int. Rev. Code of 1954, § 643(a)(5); and extraordinary dividends, Int. Rev. Code of 1954, § 643(a)(4).

¹⁶³ Treas. Reg. §§ 20.2056(b)-6(a)(2), 20.2056(b)-6(d) and 20.2056(b)-5(f) (1958).

¹⁶⁴ The statutory deduction of \$600 permitted by the Internal Revenue Code of 1954, § 642(b) is lost if there be no income to support it. The distributions may consume all income under Internal Revenue Code of 1954, § 661(a). It would be economical tax wise to withhold at least enough assets in any year to carry all deductions and the exemptions. Treas. Reg. § 1.643(a)-2 (1956). Similarly as to the dividends received credit, see Treas. Reg. § 1.643(a)-1 (1956).

¹⁶⁵ Int. Rev. Code of 1954, § 643(a).

¹⁶⁶ Int. Rev. Code of 1954, § 665.

¹⁶⁷ Int. Rev. Code of 1954, § 663.

allowance¹⁶⁸ and the statutory exemption from administration¹⁶⁹ carry income.¹⁷⁰ These amount in effect to a kind of statutory specific legacy. No real estate which descends directly to heirs is treated as having been distributed out of the estate.¹⁷¹ This amounts in effect to an approximate quasi-specific devise.

Distributable net income can be seen as a new idea built on top of older concepts¹⁷² designed to overcome the untaxed income problem and to assign income tax responsibility to various entities according to the nature of the income as it came to the estate. No correlative deduction problem can arise because the only deflection possible requires that distributable net income results only after all allowable deductions have been offset against the gross income of the estate.¹⁷³ Since deductions first must be recognized, it is not possible to carry income to any beneficiary unless there was net taxable income available to the estate as a predicate.¹⁷⁴ The honorific tax personality ordinarily recognized for estates¹⁷⁵ for federal income tax purposes has been

¹⁶⁸ The Ohio widows allowance is created under Ohio Rev. Code § 2117.20 (1953).

¹⁶⁹ The variable statutory exemption of from \$500 to \$2500 is authorized under Ohio Rev. Code § 2115.13 (1953).

¹⁷⁰ Treas. Reg. § 1.661(a)-(2)(e) (1956).

¹⁷¹ Treas. Reg. § 1.661(a)-(2)(e) (1956).

¹⁷² "Ideas are inherently conservative. They yield not to the attack of other ideas, but to the massive onslaught of circumstance with which they cannot contend. . . . Galbraith, *The Affluent Society* 20 (1958). Further: "The fatal blow to the conventional wisdom comes when the conventional ideas fail signally to deal with some contingency to which obsolescence has made them palpably inapplicable." *Id.* at 6.

¹⁷³ Distributable net income as defined necessarily implies that all deductions have been absorbed to determine income to determine the original starting point. But in the final period of the return, an approximate cognate is present through the termination deductions under the Internal Revenue Code of 1954, § 642(h). See text at *infra* notes 176 and 188.

¹⁷⁴ Distributable net income is measured not only by the events of the taxable year concerned but also by the events of later periods as they may reduce taxable income through a net operating loss carryback. Rev. Rul. 61-20, 1961 Int. Rev. Bull. No. 6, at 57 allows beneficiaries to claim refunds which arise out of an estate net operating loss carryback. The subsequent loss reduces income otherwise taxable to the estate for the earlier year; thereby the distributable net income must be reduced accordingly. The reduction to the estate correspondingly reduces income to the beneficiaries; the reduction of taxable income from the estate to the beneficiary is the basis for the refund. This result is peculiarly the product of the distributable net income concept and is the reverse of the law as drawn from the prior code. *Mellott v. United States*, 257 F.2d 798, 2 Am. Fed. Tax R.2d 5097 (3d Cir.), *cert. denied*, 358 U.S. 864 (1958); *Sargent v. United States*, 48 Am. Fed. Tax R. 1696, 55-1 U.S.T.C. ¶ 9424 (S.D. Calif. 1955).

¹⁷⁵ The term estate has been construed to have been used in its ordinary probate sense. *Laughlin Estate v. Comm'r*, 167 F.2d 828, 36 Am. Fed. Tax R. 985, 48-1 U.S.T.C. ¶ 9263 (9th Cir. 1948). But the duration of an estate will be determined according to federal law independently of whether the state law permits it to continue. Treas. Reg.

purposely eliminated in the year of termination of the estate.¹⁷⁶ In the taxable period of termination, the fiduciary's "unused loss carry-overs and excess deductions"¹⁷⁷ are carried over to the beneficiaries of the estate and are allowed as deductions to them. Thus the statute permits the beneficiaries to claim an unused net operating loss carry-over,¹⁷⁸ and an unused capital gain deduction¹⁷⁹ and an unused capital loss carry-over directly out of the estate¹⁸⁰ but not from the decedent himself.¹⁸¹ With the narrow exception of soil and water conservation expenditures unused by the estate,¹⁸² all unusable deductions in excess of gross income for the last taxable year of the estate can be carried forward to the beneficiaries. The fact of termination is crucial. If the estate is not wound up, or if unused non-operating loss deductions originated in a different taxable year,¹⁸³ they are not subject to carry-over; in these cases, they are not deductible by the beneficiaries. The lost deductions which originated in the last taxable year are available to each beneficiary in proportion to his respective economic burden¹⁸⁴ as a deduction either (1) to determine adjusted gross income¹⁸⁵ or (2) to compute net taxable income, but only if the optional

§ 1.641(b)-3 (1960); see many cases collected at 6 Mertens, *op. cit. supra* note 93 § 36.47.

¹⁷⁶ Internal Revenue Code of 1954, § 642(h) reversed in a limited application the line of cases which refused to permit deductions unused in administration to be carried across to the beneficiaries.

¹⁷⁷ Int. Rev. Code of 1954, § 642(h).

¹⁷⁸ Treas. Reg. § 1.642(h)-1(b) (1956).

¹⁷⁹ Rev. Rul. 59-392, 1959-2 Cum. Bull. 163; Treas. Reg. § 1.642(h)-1(a) (1956); Somers, "New Ruling Preserves Benefit of Capital Gains Deduction on Termination," 12 Journal Taxation 137 (1960).

¹⁸⁰ Treas. Reg. § 1.642(h)-1(a), (b) (1956).

¹⁸¹ A capital loss carry-forward unused by the decedent dies with him; it cannot be absorbed through the estate. Rev. Rul. 54-207, 1954-1 Cum. Bull. 147. Nor is it available to successors under Internal Revenue Code of 1954, § 691(b), nor through Internal Revenue Code of 1954, § 642(h).

¹⁸² Because of the erratic and probably unintended method of statement in the Internal Revenue Code of 1954, § 175, soil and water conservation expenditures not consumed by the estate under the restrictive limitations of the statute are not available to the beneficiaries under Internal Revenue Code of 1954, § 642(h), after termination. Rev. Rul. 58-191, 1958-1 Cum. Bull. 149.

¹⁸³ Treas. Reg. § 1.642(h)-1 (1956) is confined to unused net operating loss carry-over under Internal Revenue Code of 1954, § 172 and an unused capital loss carry-over under Internal Revenue Code of 1954, § 1212. Furthermore, the time for carry-over is reduced by the fact that the year of the termination is counted in determining the carry-over period.

¹⁸⁴ Treas. Reg. § 1.642(h)-3 and 4 (1956) contain a series of specific allocation standards by which the benefit of the deductions are permitted to those who bear the burden. See also Rev. Rul. 60-134, 1960-1 Cum. Bull. 259.

¹⁸⁵ Treas. Reg. § 1.642(h)-1(b) (1956); this applies only to the net operating loss carry-over and the capital loss carry-over.

standard deduction is waived.¹⁸⁶ The waiver requirement depends upon the underlying nature of the deduction as it is traced out of the estate and carried to the successor's income tax return. If the item was a net operating item, it is deductible independently of the option; but if the deductions were not built on an operating loss¹⁸⁷ then the optional choice must be asserted and all deductions must be itemized.¹⁸⁸

CONCLUSION

The application of these principles involve interrelated choices between taxable persons and various taxing theories. They are influenced by the dimension of time, the realities of death and the facts of receipt, payment or accrual. These relationships must deal with the complexity of interlocking persons, natural and legalistic, the need for doctrines of taxation which operate equitably and which at the same time serve the needs of the public fisc.

The tax experts, [we are told], have done a magnificent job of creating a morass into which any mere probate or trust lawyer must fear to tread. . . .¹⁸⁹

That "taxation is an eminently practical matter"¹⁹⁰ is indisputable. That it is a modern accretion to the historical doctrines of the law¹⁹¹ should be readily apparent even to him who reads while running.¹⁹² To combine "the plain purposes of a modern fiscal measure [with]

¹⁸⁶ Int. Rev. Code of 1954, § 141. Of course, the standard deduction is never available to the estate. Treas. Reg. § 1.142-2 (1957).

¹⁸⁷ Treas. Reg. § 1.642(h)-2(a) (1956); the net income alternative computation applies to all termination deductions except the capital loss and operating loss carry-overs. See *supra* note 185.

¹⁸⁸ See *supra* notes 185 and 187.

¹⁸⁹ Sutter, "Simplification of Income Taxation of Estates and Trusts," Proceedings of Probate and Trust Law Section, American Bar Ass'n., Miami, Florida, 1959, Irving Trust Co. reprint 44.

¹⁹⁰ Mr. Justice Peckham, *Nicol v. Ames*, 173 U.S. 509, 519, 3 Am. Fed. Tax R. 2661 (1899); Mr. Justice McReynolds, *Farmers Loan & Trust Co. v. Minnesota*, 280 U.S. 204, 8 Am. Fed. Tax R. 10257, 10259 (1930); Mr. Justice Sutherland, *Tyler v. United States*, 281 U.S. 497, 503, 8 Am. Fed. Tax R. 10912, 2 U.S.T.C. ¶ 532 (1930); Mr. Justice Black, *United States v. Jacobs*, 306 U.S. 363, 22 Am Fed. Tax R. 282 (1939).

¹⁹¹ "The foundations of Federal tax law all revolve around basic relationships recognized by every day law. All the tax problems must pivot on legal concepts because they govern the transactions which create the taxable events. The basic concepts underlying a tax system cannot change anymore than the legal system itself changes. . . ." Rabkin & Johnson, *Federal Income Gift & Estate Taxation*, Report No. 225, "A Preface to an Anniversary," Preface iii, *passim*, April, 1961.

¹⁹² Habakuk 2:2 used the phrase "he who runs may read." This identical phrase was used by Kalodner, J., without reference to its origin. *Roebeling v. Comm'r*, 143 F.2d 810, 814, 32 Am. Fed. Tax R. 1083, 44-2 U.S.T.C. ¶ 9388 (3d Cir.), *cert. denied*, 323 U.S. 773 (1944).

the wholly unrelated origins of the recondite learning of ancient property law"¹⁹³ will necessarily cause complications "in a field beset with invisible boomerangs."¹⁹⁴ "Orthodox principals have to be trimmed and hauled to meet the unique necessities of the insatiable tax gathering process."¹⁹⁵

The federal tax law is a spit compounded of fiscal necessity and the desire to disturb existing patterns as little as possible. On it has been skewered fifty differing local law versions of a trichotomy of property devolution devices drawn from historical accidents. Out of this amalgam, it seems inescapable that the morass be confused. The real wonder is that it makes as much sense as it does.

¹⁹³ Mr. Justice Frankfurter, *Helvering v. Hallock*, 309 U.S. 106, 23 Am. Fed. Tax R. 1054, 1058, 40-1 U.S.T.C. ¶ 9208 (1940).

¹⁹⁴ Mr. Justice Jackson, dissenting, *Arrowsmith v. Comm'r*, 344 U.S. 6, 42 Am. Fed. Tax R. 649, 653, 52-2 U.S.T.C. ¶ 9527 (1952).

¹⁹⁵ Judge Brown, *Patchen v. Comm'r*, 258 F.2d 544, 2 Am. Fed. Tax R. 5433, 5439, 58-2 U.S.T.C. ¶ 9733 (5th Cir. 1958).